Public Utilities

FORTNIGHTLY

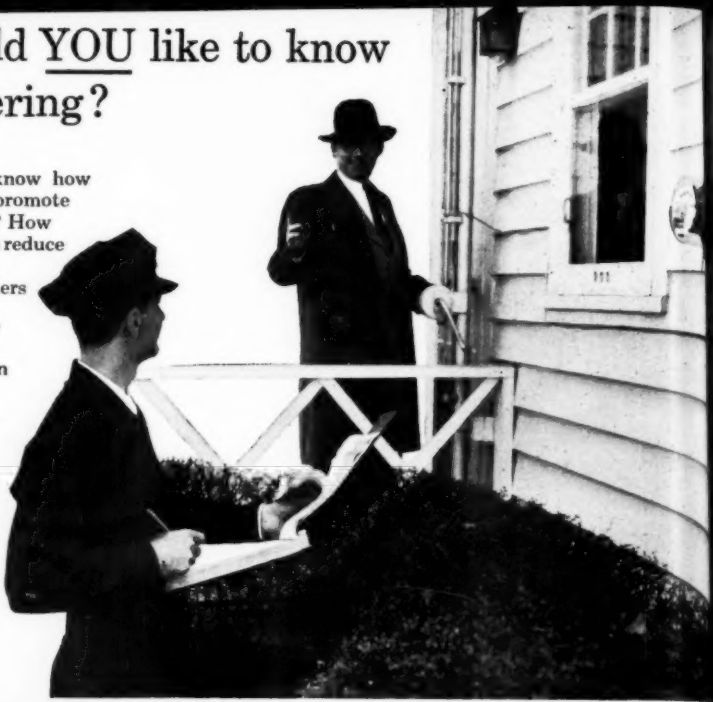
Volume L No. 9 October 23, 1952

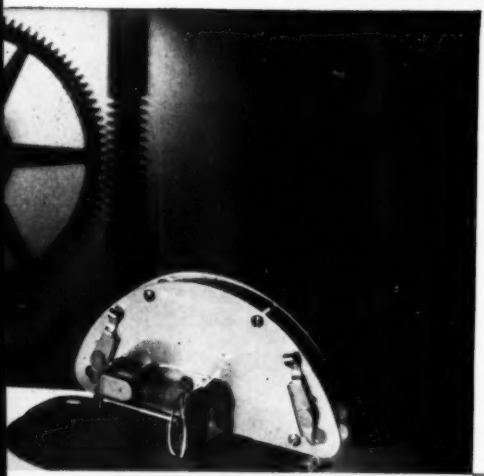
PUBLIC UTILITIES REPORTS, INC., PUBLISHERS

What would YOU like to know about metering?

Would you like to know how modern meters can promote good public relations? How dependable meters can reduce operating costs? And, how well-designed meters save operating and maintenance expense?

If you are interested in the answers to these and many other questions, get your copy of "Metering for Profit." It's yours for the asking.





HAT IS A SHADOWGRAPH? This illustration, from "Metering Profit," shows the magnifying device used to assure an exact justment of the mesh between the worm spindle of a meter k and the worm wheel of the register. The use of the shadow-aph is another step to assure that your meters register fully kilowatthours consumed.

Only Measured Facts are Known Facts

SANGAMO ELECTRIC COMPANY

SPRINGFIELD, ILLINOIS

Write for "Metering for Profit"

A non-technical report to utility company personn concerning watthour meters. If you are interested in metering and its effect on profits, it should be "must reading." The coupon will assure you of a copy.

IT'S FREE!

SANGAMO ELECTRIC COMPANY, SPRINGFIELD, ILLIN

Please send my free copy of "METERING FOR PROFIT"

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COMPANY_____

CITY AND ZONE_____ STATE_____

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Public Utilities FORTNIGHTLY

VOLUME L OCTOBER 23, 1952 NUMBER 9

ARTICLES

FEATURE SECTIONS

PUBLIC UTILITIES REPORTS, INC., PUBLISHERS

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PUBLIC UTILITIES FORTNIGHTLY.. stands for Federal and state regulation of both privately owned and operated utilities and publicly owned and operated utilities, on a fair and nondiscriminatory basis; for nondiscriminatory administration of laws; for equitable and nondiscriminatory taxation; and, in general—for the perpetuation of the free enterprise system. It is an open forum for the free expression of opinion concerning public utility regulation and allied topics. It is supported by subscription and advertising revenue; it is not the mouthpiece of any group or faction; it is not under the editorial supervision of, nor does it bear the endorsement of, any organization or association. The editors do not assume responsibility for the opinions expressed by its contributors.

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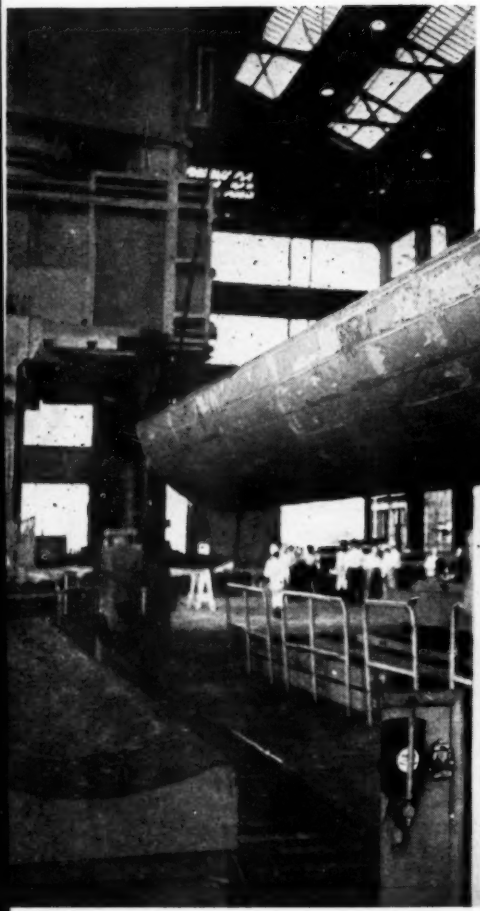
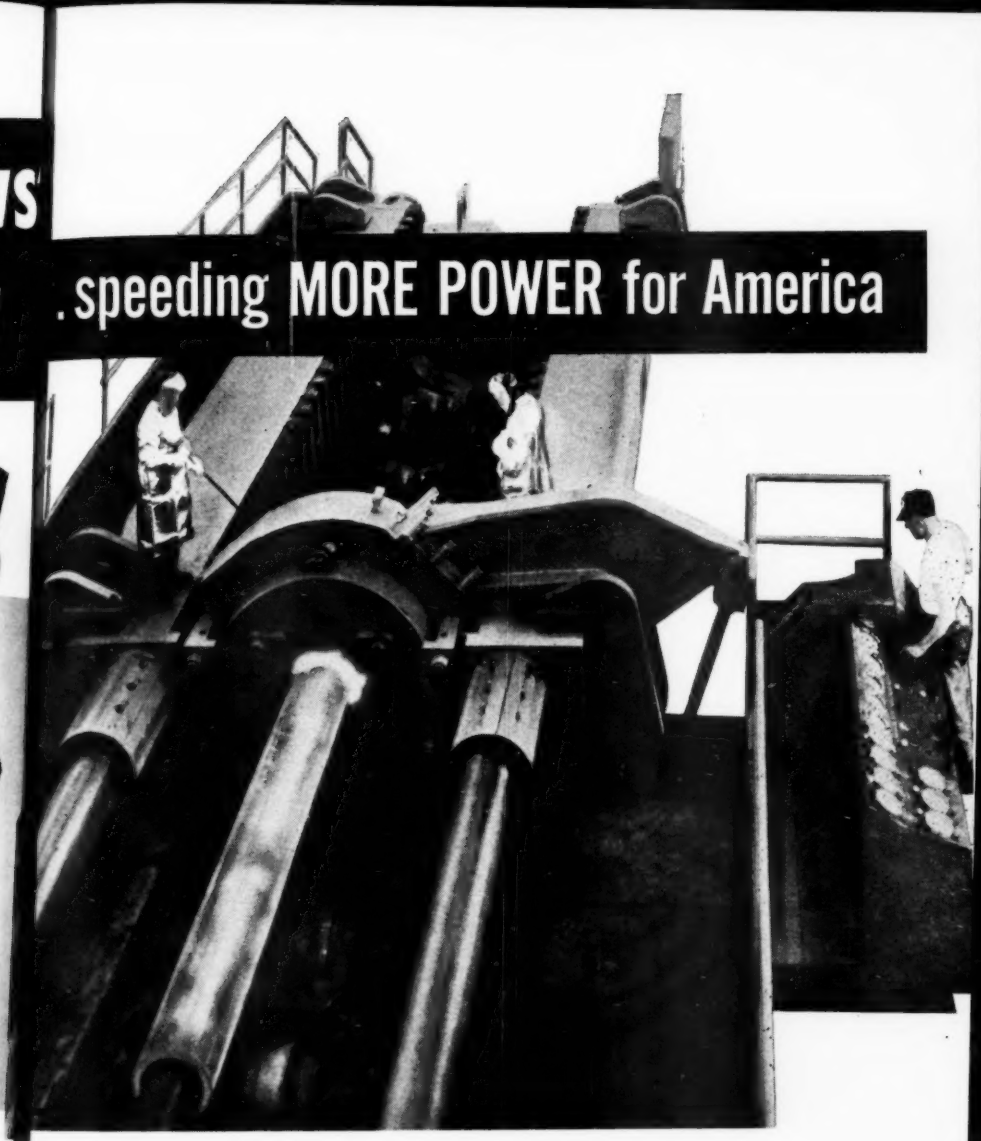
BIG "NEWS" at B&W



This mammoth draw bench installed by Babcock & Wilcox introduces into America a unique method for faster forming of headers and other seamless hollow forgings for the high pressure and temperature conditions in modern steam generating units. This method uses less steel, is quicker and more flexible than previous procedures . . . heavy-wall piping and hollow boiler parts up to 35 inches outside diameter with 4½-inch walls and 22 feet long are forged with great speed.

Huge steel plates 42 feet long are formed into sections of massive boiler drums on a new press installed by Babcock & Wilcox. Largest ever built for this purpose, the press is speeding fabrication of power plant boilers by considerably reducing total plate bending time and permitting use of fewer and larger boiler drum sections, thus eliminating welding and X-raying of additional seams required when smaller plates are used. The new press, designed and under construction in advance of the electric companies' record power expansion, bends thicker boiler drum plate than does any other equipment now in operation, and enables B&W to build steam generating units for the highest pressure and temperature conditions that may be anticipated.



Highlighting a multi-million dollar expansion program at Babcock & Wilcox are two new giant machines to speed production of steam generating equipment for America's electric companies. Along with other new production facilities, more trained personnel, and three additional plants, these new machines are geared to forecasts of, and B&W's faith in, power's future.

BABCOCK & WILCOX

G-57

Pages with the Editors

We should explain both the extra large size and the abbreviated regular sections of this particular issue of the FORTNIGHTLY. Following our annual practice of recent years, we are giving to our readers the benefit of the excellent regulatory discussion by top-flight legal practitioners and other experts at the recent annual meeting of the Section of Public Utility Law of the American Bar Association in San Francisco. It was believed to be more desirable to combine all of these excellent papers in one thumping big issue, than to split them up into two instalments, as was done last year.

THE net result, however, has been to crowd our regular departments to some extent. We are still able to present some exceptionally fine features. For example, the opening feature in this issue covers a story which every regulatory commissioner and staff member and regulatory practitioner may well read with interest and profit, we are sure. It covers the reorganization of a modern regulatory commission.

WHEN it all began in 1907, the New York Public Service Commission was frankly an experiment conducted by five commissioners and a handful of employees. By 1930, the staff had grown to 267 and by 1949 to 610. But the increasing duties and complexities of regulation in the great state of New York resulted in a state budget bureau recommendation for a reorganization on a functional basis.

© *Fabian Bachrach*

BENJAMIN F. FEINBERG

THE result put into practice during the past fiscal year has been probably the most comprehensive reorganization of a major state regulatory board in the country. It may even be a model for similar well-planned changes and adjustments elsewhere in the interest of efficiency and effective operation. CHAIRMAN BENJAMIN F. FEINBERG, under whom these extensive changes have taken place, gives us a complete before-and-after account of the reorganization of the New York Public Service Commission.

JUDGE FEINBERG, as he is known to his many friends in New York state and elsewhere, has a distinguished record in public service, which began as a city judge at Plattsburg, New York, in 1922. Born in Malone, New York, JUDGE FEINBERG graduated from Albany Law School of Union University (LLB, '11) and practiced law in Plattsburg. In 1932 he was elected to the New York state senate where he remained to become Republican Majority Leader under the Dewey administration. He is the author of one of the most celebrated anti-Communist laws on the nation's statute books—the Feinberg Law passed in 1949, which prohibits Communists teaching in the New York public schools. Since he was appointed chairman of the New York Public Service Commission, JUDGE FEINBERG has rapidly assumed the position of an active leader in regulatory discussions. We are sure his contribution in this issue will be helpful to our many good friends and readers on the regulatory commissions.

What goes on at this Round Table?

• They could be exchanging ideas on new financing . . . discussing the cost of new money . . . hearing an expert appraisal of long-term trends for utilities.

Those present, in addition to the public utility executives, include experts from investment banking institutions, insurance companies, rating agencies—and from numerous other types of financial organizations.

Yes, this is a typical Public Utility "Round Table" at the Irving. Last year alone, 146 representatives from 85 utility companies attended these sessions.

These "Round Tables," now going into their sixth year, are one of the ways we seek to serve the public utility industry. As specialists in this field, we are constantly on the lookout for ways to be of practical help. If your company has an unusual problem, that's the kind of challenge we welcome.

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Public Utilities Department—TOM P. WALKER, *Vice President in Charge*

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PAUL HALLINGBY, JR.

IT goes without saying that personalized investor relations are important to utility industries. PAUL HALLINGBY, JR., of the Middle South Utilities Company (whose article on investor relations begins on page 547), has written a brief but valuable and up-to-date account of what can be done to make groups of stockholders, particularly institutional investors and analysts, familiar with a given utility system operation.

BORN in Los Angeles, HALLINGBY is an engineering graduate of Stanford University (BA, '41) and Harvard Business School. Following service with the Navy as a Lieutenant Commander during World War II, he came to New York city and entered the investment field with The First Boston Corporation and E. F. Hutton & Company. He joined his present organization early this year.

* * * *

NOT only legal, but economic and financial problems of operating public utilities engaged the attention of the Section of Public Utility Law of the American Bar Association. We can give only a bare statement regarding the authors whose papers appear in the appendix in this issue. First as to the presiding officers. There was A. J. G. Priest of the well-known public utility law firm of Reid & Priest of New York city. Mr. Priest was chairman of the Council on Public Utility Law for the year ending with the September meeting. Also presiding was his vice chairman, who became chairman for the current year, Jonathan C. Gibson of Chicago, vice president and general counsel of the Atchison, Topeka & Santa Fe Railway.

THE first of the three sessions was based on the annual report of the section's standing committee to survey developments during the year in the field of public utility law. This report was submitted and summarized by the committee's chairman, Julian de Bruyn Kops, general counsel of the Dayton Power & Light Company, Dayton, Ohio. Members of the panel participating in this discussion included Milford Springer, Los Angeles attorney for the Southern Counties Gas Company and formerly a member of the FCC legal staff; George L. Buland of San Francisco, vice president and general counsel, Southern Pacific Company; Fletcher Rockwood of Portland, Oregon, attorney for the Pacific Telephone & Telegraph Company; and Judge E. C. McKeage, chief counsel of the California Public Utilities Commission.

THE second session, devoted to discussions of depreciation policies, included Clarence H. Ross of the Chicago law firm of Daily, Dines, Ross & O'Keefe; George J. Eder of New York city, assistant general attorney for the International Telephone & Telegraph Company; and Charles W. Smith of Washington, D. C., chief accountant for the FPC.

THE final session, devoted to the regulatory lag, featured papers by William A. Dougherty of the New York law firm of Dougherty & White; Allan P. Matthew, a San Francisco railroad attorney; the Honorable Harold P. Huls, associate member of the California Public Utilities Commission; and E. H. Burgess, vice president, Baltimore & Ohio

THE next number of this magazine will be out November 6th.

The Editors

Coming IN THE NEXT ISSUE

★

Natural Gas Growth Carries Gas Industry to New Heights

Charles E. Bennett, president of the American Gas Association, has written a comprehensive story of gas industry progress over the past year. Basing his predictions on trends which have been evident, he believes the industry will establish new records in 1952. This encouraging report is presented as a timely message as gas industry people gather for their association's annual convention at Atlantic City, New Jersey, October 27th to 30th. The industry is looking ahead with optimism, despite the problem of time lag in regulatory relief, to a greater future, and increased expansion in the years ahead.

Why A PAD Order No. 2—And How Long?

Howard B. Noyes, Assistant Deputy Administrator for gas transmission and distribution operations of the Petroleum Administration for Defense, reviews the recent wartime and postwar history of gas industry progress. The initial difficulties and eventual successes are described. The author advises that all-around industry-government cooperation would bring gas demand and supply into early balance.

Is FPC Gas Cost Allocation Equitable?

Larry Shomaker is vice president of the Northern Natural Gas Company. Recently, his company (along with a few others) has borne the brunt of several FPC decisions which have created some concern in the industry and related fields generally. The company has had applied to it the FPC's "cost of money" theory in determining natural gas industry rate of return which may be gradually adopted by the FPC. The author's comment upon the basis for the FPC's cost allocation is another important regulatory question peculiar to pipeline operations. This is a subject which is likely to get added attention by other writers.

The Care and Feeding of Corporate Stockholders

Here is an interesting analysis of the types of corporation, their attitude toward stockholder relations, and the types of stockholders. The need of a stockholder relations program is admitted. The author probes into its proper launching, philosophy, and communication media. Timely tips on how to treat the "more sophisticated stockholders"—analysts, banks, and insurance companies—are provided by the author, Dale Parker, secretary of Columbia Gas System, Inc.

Training Men for the Gas Industry

There is one institution of higher learning which, in pursuing a single purpose, actually serves two: the gas industry and the general public. This unique educational institution is the Institute of Gas Technology. Affiliated with the Illinois Institute of Technology, "Gas Tech" was founded to train men for careers in the gas industry. Its dean, Joseph D. Parent, describes the curriculum and research activities—both representing outstanding contributions to the industry.

The Gas Industry's Man-power Problems

Here is an interesting, illusion-dispelling article on attracting and holding valuable personnel. F. O. Rouse, consultant for Commonwealth Services, Inc., considers the obstacles faced in building and operating the teams needed to run the growing gas industry.

Gas Industry Looks at Public Relations

For some time leading figures in the gas industry have been considering the advisability of adopting an industry-wide public relations program. What the steps in that direction have been, and how the plan is currently shaping up, are ably described by a close observer in this field, John J. Hassett.

★

Also . . . ***Special financial news, digests, and interpretations of court and commission decisions, general news happenings, reviews, Washington gossip, and other features of interest to public utility regulators, companies, executives, financial experts, employees, investors, and others.***

Remarkable Remarks

"There never was in the world two opinions alike."
—MONTAIGNE

HERBERT HOOVER
Former President of the United States.

"Controls of the type we have imposed on wages and prices cannot in the long run prevent inflation. The experience of six great commercial nations in two wars has proved that they are, at best, a retarding device."

JAMES B. CONANT
President, Harvard University.

"If you desire technical progress in the practical arts, you must stimulate ingenious men to vie with one another to improve the practical art in question. The advocates of public ownership of the means of production have rarely faced up to this aspect of the history of modern industry."

HARRY P. CAIN
U. S. Senator from Washington.

"Much legislation is based on wrong premise. When Congress heard only from the government bureaucrats, it was half-minded to establish a Columbia Valley Authority. But when the governors of four states went to Washington to protest, CVA became for the time being a dead issue."

M. S. RUKEYSER
Columnist.

"The true alternative to a regimented police state is a free choice society, in which men and women will have free choice as to goods and services, on the one hand, and as to jobs, on the other. In contrast the 'planned society' negates individual freedom, and operates by directives from little commissars in big jobs."

HAROLD R. MEDINA
Federal judge of New York.

"Boys just out of college ask personnel directors what the pension rights are and at what age they will be allowed to retire. Croakers abound everywhere telling us that everything is going to pot, that the world is plum full of corruption and that nothing can be done about it. But the truth is that this do-nothing policy of playing everything safe is just about the worst thing that a person can do."

REESE H. TAYLOR
President, Union Oil Company of California.

"We cannot look at what is happening to this nation today and wonder whether we should or should not speak the truth and tell the facts to the people. We have a responsibility to the owners of business, the employees of business, and the consumers of business' produce. If we allow this spending and taxation to destroy our productive ability without doing everything in our power to stop it, we have not lived up to our responsibilities."

Now! *a film that shows you...*

"The Legend of Dan and Gus" is a 30-minute 16mm color and sound motion picture, combining animation and live photography.

The differences between a regulated public service company—and a non-regulated private industry.

"The Legend of Dan and Gus" introduces two young brothers to the U. S. business scene, together with the firms they founded—*Dan's Doorknob Company* and *Gus' Gas Company.*

In their own way, Dan and Gus are an American success story. They learn to weather economic cycles, material shortages, competition, expansion crises, and a host of other challenges. They learn first hand that regulated and non-regulated businesses are different, and each has its own problems that must be met in different ways.

If you would like to view "The Legend of Dan and Gus" or desire further information about it, write on your letterhead to: Director of Information, The Columbia Gas System, Inc., 120 East 41st Street, New York 17, N. Y.

COLUMBIA GAS SYSTEM

COLUMBIA GAS SYSTEM

JOHN HOLMES
President, Swift & Company.

"If excessive taxes continue there simply will not be any venture capital. Complete disappearance of risk capital will be a serious blow to private enterprise."

IRVING M. IVES
U. S. Senator from New York.

"When the Federal government takes into its own hands the regulation of every aspect of our progress—business, educational, even health—then I say it is using those hands to strangle rather than to help."

R. STAFFORD EDWARDS
President, Edwards Company.

"We have little to worry about as a result of a contest between large and small business. But we have reached a stage where both large and small business must worry about being regulated to the point of extinction by government."

ERWIN D. CANHAM
Editor, Christian Science Monitor.

"The best way to prevent the theft of our freedoms is to make sure the people understand their importance, and so I think newspapers must continue to explain, to illustrate, and to exemplify in their daily service the importance of information to people."

GUSTAV METZMAN
Chairman of the board, New York Central System.

"Any serious impairment of railroad services resulting from lack of capital would not long be tolerated by the American public. Such a situation would inevitably create public demand that the government supply the needed money. That would be nationalization whatever name might be given it."

LAURENCE F. LEE
President, Chamber of Commerce of the United States.

"The great bulwark of safety for the free enterprise system is a Congress composed of men committed to the principle of free competition—and the free market. Presidential election years have a habit of distracting our attention from a primary fact—that it is the Congress which enacts our laws and shapes our policies."

EDITORIAL STATEMENT
The Wall Street Journal.

"A government, like a family, is on shaky economic ground when it spends more than it takes in. It may look like prosperity, but if there's nothing in the sock, the sheriff usually comes right behind the rainy day. A nation in debt is only millions of families in debt and the one thing worse is for both to be in debt at the same time. The planners say this is all wrong, but old Ben Franklin knew it for the truth."

LEWIS HANEY
Columnist.

"By learning true economic and political principle based on past thought and experience we can do two things: We can hasten the day of awakening to the bankruptcy of New Deal Socialism. We can provide leadership for that day, so that when we the people demand 'a change,' we shall find those who know where to go. If we will learn by experience, as we still can, we may avoid the wringer and hasten the recovery."

Is communication

AUTOMATIC ELECTRIC

A complete line of communication equipment for the power industry:

P-A-X Business Telephone Systems

Lenkhurt Carrier Telephone and Telegraph Systems

Microwave Radio Communications Equipment

Relays, Rotary Switches and other Electrical Control Equipment

really *working* for you?

Are you getting *all* the economies, *all* the operating efficiency, that modern communication facilities can give you?

Just ask your communications superintendent!

Ask him about P-A-X Business Telephone Systems—the modern *automatic* telephone systems now owned and used by 70 of the leading power companies in the country. Ask him about "carrier" and about "microwave" radio—the economical ways to extend communication channels *where* you need them, *when* you need them, without costly wire-line construction. . . . Ask him to tell you about Automatic Electric Company.

Communications men throughout the power industry know Automatic Electric as the makers of P-A-X Business Telephone Systems. With P-A-X, many power companies are discovering efficiency unimagined before—simply by separating their load of "inside" telephone calls from their volume of outside calls—by handling all "internal" communication over a separate system of P-A-X automatic telephones! And when P-A-X Systems are connected by microwave and carrier channels to link stations along the line, these same efficiencies are increased many times!

Originator of the automatic dial telephone system, Automatic Electric has a background of sixty years' experience in communication. Here is an organization of *communication specialists*, ready to work with your organization—to make communication *work* for you, as it is doing for many others!

Your communications officials probably know the Automatic Electric representative; or just call us at HAymarket 1-4300 in Chicago.

Widespread operations of a leading oil company are knit together by a P-A-X Business Telephone System. Write for your copy of the illustrated 12-page result story.

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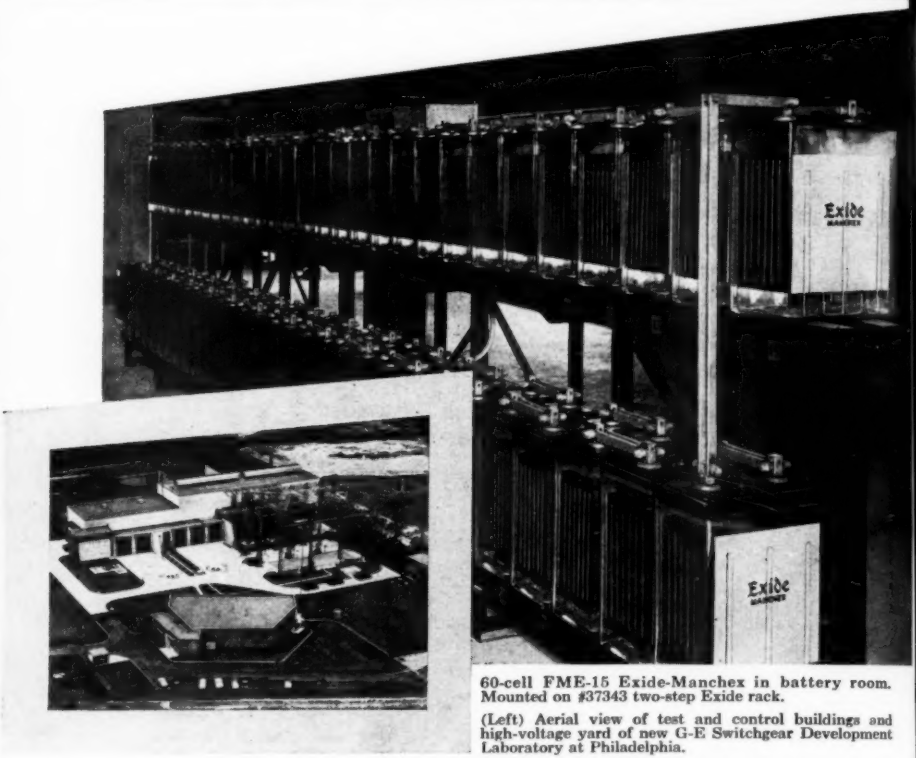

60-cell FME-15 Exide-Manchex in battery room. Mounted on #37343 two-step Exide rack.

(Left) Aerial view of test and control buildings and high-voltage yard of new G-E Switchgear Development Laboratory at Philadelphia.

IN THE NEW G-E SWITCH GEAR DEVELOPMENT LABORATORY

Exide-Manchex BATTERIES

"Largest of its type in the world!" These are among the words used to describe the new high-capacity development laboratory of the General Electric Company. It is capable of delivering 5,250,000 kva asymmetrical, 3,200,000 kva symmetrical, 3 phase, at generator voltage, and of testing power circuit breakers and other switchgear apparatus at voltages up to 440,000 volts.

The battery being used for tripping and closing the breakers in this development work is the Exide Manchex. The battery will also be used for oscillograph operations and to supply indicating lamp loads and power for two 15-hp lube oil emergency pumps for the generators.

With Exide-Manchex Batteries on the job, you can always count on positive switchgear operation . . . instantaneous power . . . extra long battery life . . . low costs of operation, maintenance, depreciation. Exide is your best battery buy . . . *at any* price.

• • •

Various sizes and types of Exide Batteries, up to 100 ampere-hours capacity, are available in plastic containers.

THE ELECTRIC STORAGE BATTERY CO.
Philadelphia 2

Exide Batteries of Canada, Limited, Toronto

"Exide" and "Manchex" *Reg. T.M. U.S. Pat. Off.*

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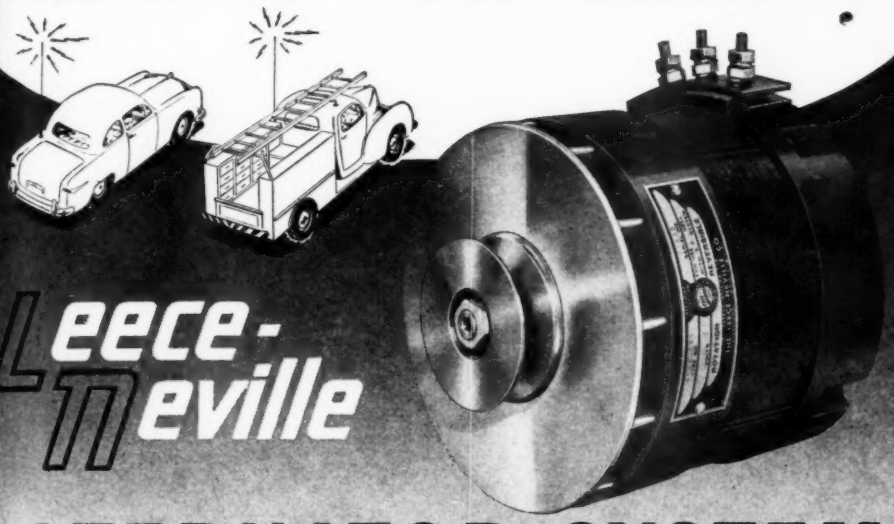

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SOME OF THE MANY UTILITIES USING THE LEECE-NEVILLE ALTERNATOR SYSTEM

Monroe County Electric Coop.
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Southwestern Public Service Co.
Central Arizona Light & Power Co.
Kansas Gas and Electric Co.
San Diego Gas and Electric Co.
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Arkansas Power & Light Co.
Ozarks Rural Electric Coop.
Illinois Bell Telephone Co.

Since 1946 Leece-Neville AC-DC Alternator Systems have been delivering unmatched performance. On 2-way radio cars and trucks... or wherever current demands are high, L-N Alternators give:

- *25 to 35 amps with engine idling*
- *ample capacity to carry the entire electrical accessory load*
- *fully charged batteries always*
- *better radio operation*

There are L-N Alternator Systems rated at 50 amps and 80 amps for 6-volt systems; 60 to 150 amps for 12-volt systems.

Ask us to arrange a demonstration of the L-N Alternator for your fleet. Or write for all the facts. The Leece-Neville Company, Cleveland 14, Ohio. *Distributors in principal cities... Service Stations everywhere.*

YOU CAN RELY ON Leece-Neville

Heavy Duty Automotive Electric Equipment for Over 43 Yea

ALTERNATOR SYSTEMS • GENERATORS • STARTING MOTOR
REGULATORS • SWITCHES • FRACTIONAL HP MOTORS

NOW!

the greatest automatic control for water heaters ever offered

ONLY THE NEW A-P GASAPACK COMBINES 10 BIG FEATURES – ALL IN ONE CONTROL!

HERE it is! A-P's new automatic control that regulates gas water heaters to close, even temperatures with complete safety. It can be used on all gases; natural, manufactured or L.P.

The big news is in the design of this new Model 50 Gasapack. It's loaded with advanced features that prove why A-P has a reputation for making time-saving, inventory-reducing and money-making improvements.

For instance, you don't have to insert a spud into your heater tanks when you use Model 50. Contact type thermobulb secures firmly in position *against* the tank. Think of the advantages this gives you. No spud leakage! No chance for water to get into gas line — or vice versa. Better opportunity for product design, too. It even helps nail down your product guarantee . . . makes it worth more to you and your customers.

And that's not all, there are many more sales-building features. In fact, look at the list at left. You'll see why the Model 50 Gasapack gives you better product performance, more customer satisfaction and more profits.

Get all the facts about this trouble-proof A-P control. Find out how you can use it on your line of gas hot water heaters. Write today for bulletin G16.

10 big reasons why new A-P Model 50 Gasapack is better:

- Provides close, even water temperature regulation.
- Large pilot filter capacity (3 cu. ft.) — ample for any requirement.
- Automatic recycling, high temperature, high pressure shut-off.
- No spud to cause leakage.
- No possibility of water getting into gas line, or vice versa, since the two aren't in contact.
- All orifices removable from the front for easy service.
- Control unit and burner can be mounted integrally—installed, removed and serviced as a unit.
- 100% safe, automatic operation.
- All parts and valve seats impervious to gases; immune from corrosion.
- Easy to clean and service.

A-P DEPENDABLE Controls

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In Canada: A-P Controls Corporation Ltd., Cooksville, Ont.

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New Issue

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Dated October 1, 1952 **Due October 1, 1982**

Price 101.871% and Accrued Interest

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H. Hentz & Co. **E. F. Hutton & Company**

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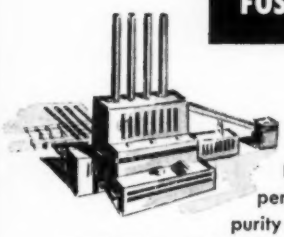
October 2, 1952.

From the pioneering development in Superheaters to th

the trend in modern steam generator design

places the spotlight on . . .

FOSTER WHEELER combination radiant and convecti



Today's central station calls for larger unit sizes of turbines and boile higher steam pressures and temperatures—and optimum quality and performance. To provide steam in the quantity, pressure, temperature a purity demanded, increased emphasis falls upon the design and function superheaters and reheaters. Their integration with other components of equipment and plant requires the high degree of skill and experience that comes only with years of leadership in the field.

Foster Wheeler's pioneering effort in steam generator design, as reflected in the following record of achievement, has led the way for every major development in the reheat cycle.

1902 — Superheated steam introduced commercially in the United States.

1904 — Convection superheaters standardized with cast iron extended surface rings applied to steel tubes. Bare tubes were later used with improved design technique and improved metal selection.

1919 — Radiant superheaters developed after long research and experimentation.

1924 — Water walls and water backs applied to many types of furnaces burning various fuels.

1926 — Radiant reheaters and radiant superheaters installed in one of the first large high pressure reheat units in the country.

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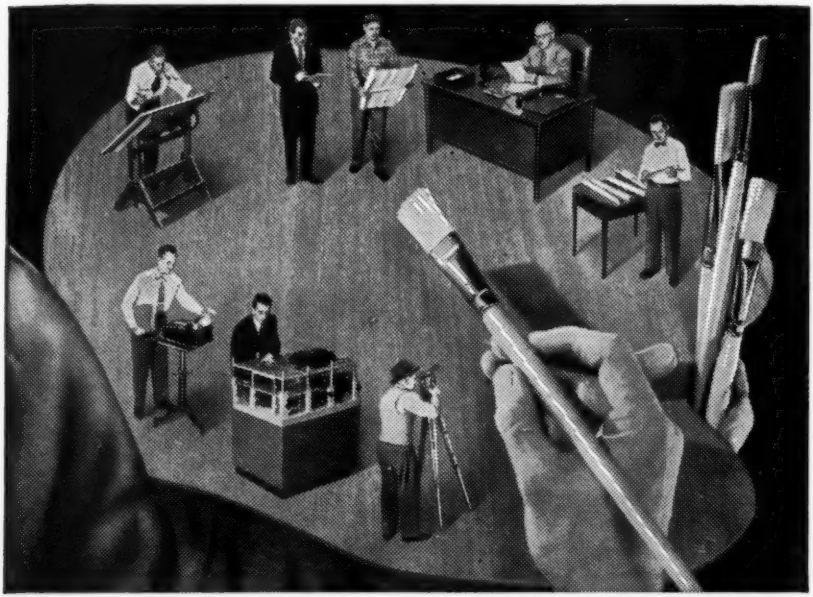

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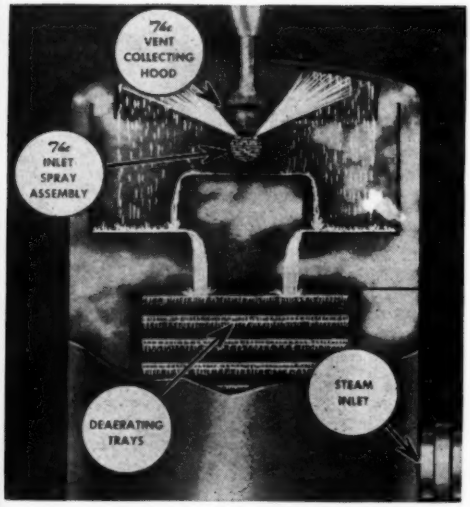
ELLIOTT deaerating heaters



The tubular vent condenser with its many small tubes, formerly mounted on top of the deaerating heater shell, is replaced by the inlet spray unit and vent collecting hood located inside the shell. Saves maintenance, saves headroom, makes a better installation.

The distinguishing mark of any new important station is apt to be the newest type Elliott deaerating feedwater heater mounted upon its storage tank, silhouetted against the sky.

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N-1081

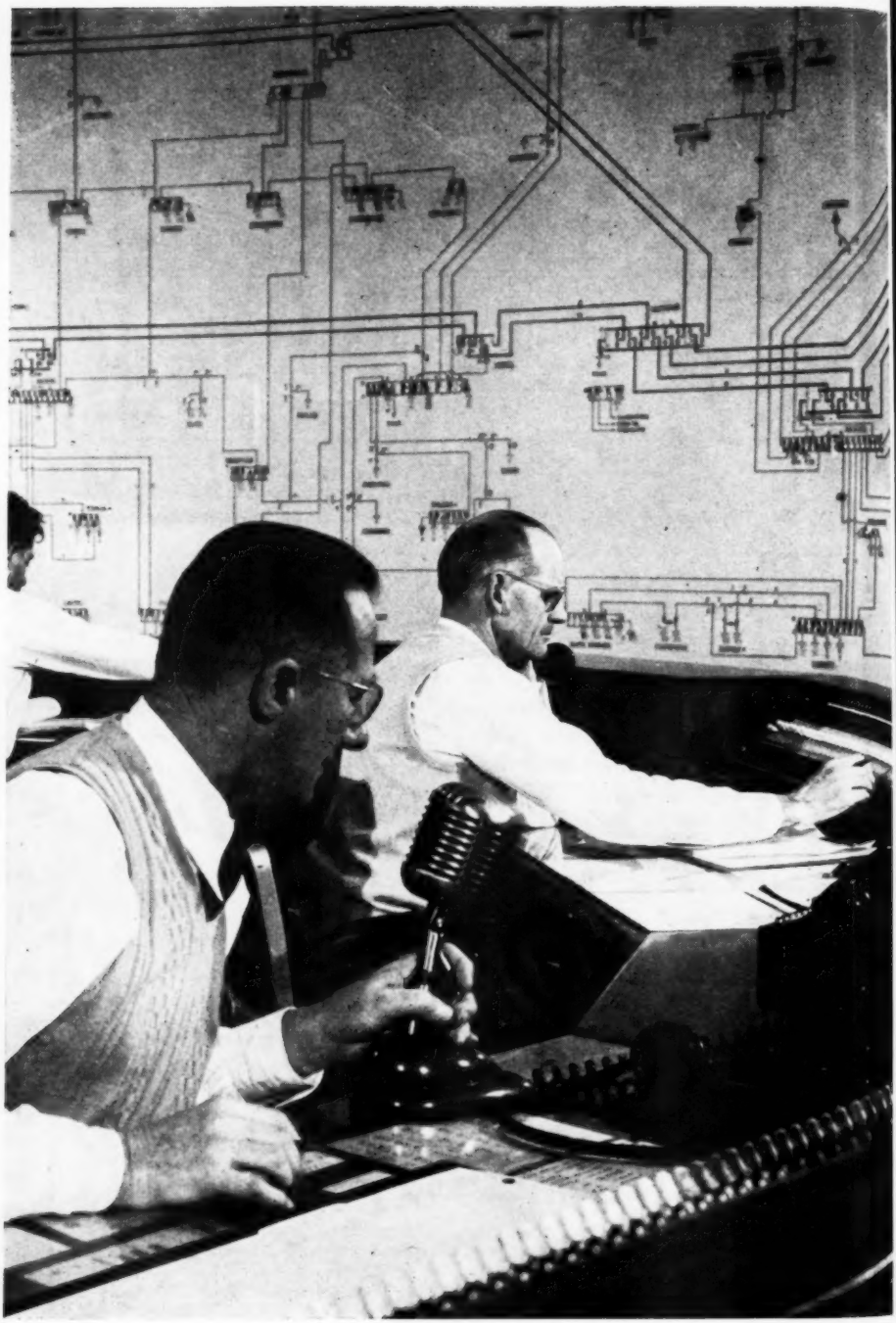
Utilities Almanack

October

23	T[h]	¶ *Institute of Gas Technology begins annual meeting, Chicago, Ill., 1952.* ¶ *North Carolina Independent Telephone Asso. begins convention, Pinehurst, N. C., 1952.*
24	F	¶ *Oklahoma Utilities Association, Electric Light and Power Division, Eastern District, begins meeting, Shawnee, Okla., 1952.*
25	S[a]	¶ *American Water Works Association, New Jersey Section, ends meeting, Atlantic City, N. J., 1952.*
26	S	¶ *Pennsylvania Electric Association, Communications Committee, will hold meeting, Syracuse, N. Y., Nov. 6, 7, 1952.*
27	M	¶ *American Gas Association begins annual convention, Atlantic City, N. J., 1952.*
28	T[u]	¶ *Georgia Telephone Association ends 2-day annual convention, Atlanta, Ga., 1952.*
29	W	¶ *Public Information Program begins regional meeting, Birmingham, Ala., 1952.* ¶ *Southeastern Electric Exchange begins sales conference, Birmingham, Ala., 1952.*
30	T[h]	¶ *Liquefied Petroleum Gas Asso., Northeast Sec., begins meeting, Atlantic City, N. J., 1952.* ¶ *South Carolina Independent Telephone Asso. begins convention, Clemson, S. C., 1952.*
31	F	¶ *Gas Appliance Manufacturers Association ends 5-day exposition, Atlantic City, N. J., 1952.*

November

1	S[a]	¶ *National Association of Railroad and Utilities Commissioners will hold annual meeting, Little Rock, Ark., Nov. 10–13, 1952.*
2	S	¶ *National Electrical Manufacturers Association will hold annual meeting, Atlantic City, N. J., Nov. 10–13, 1952.*
3	M	¶ *Minnesota Petroleum Gas Association begins one-day meeting, Minneapolis, Minn., 1952.*
4	T[u]	¶ *American Standards Association will hold annual meeting, New York, N. Y., Nov. 19, 1952.*
5	W	¶ *American Water Works Association, Virginia Section, begins annual meeting, Old Point Comfort, Va., 1952.*



Power Dispatchers

Scene from General Electric's new film "Freedom and Power"

Public Utilities
FORTNIGHTLY

VOL. L, No. 9 October 23, 1952

Reorganization of a Modern Regulatory Commission

A New York state budget recommendation in 1951 has resulted in a change which may well be a model for similar well-planned changes and adjustments elsewhere in the interest of efficiency and effective operation. The head of the regulatory board, under whom these extensive changes have taken place, gives us a complete before-and-after account of the reorganization of the New York Public Service Commission.

BY THE HONORABLE BENJAMIN F. FEINBERG*
CHAIRMAN, NEW YORK PUBLIC SERVICE COMMISSION

THE public service commission of the state of New York underwent extensive reorganization in 1951. Out of the changes grew new procedures and functions designed to render greater and more expeditious service to the people and to the utilities subject to regulation.

Utility regulation as practiced in New York state today goes back to 1907 when the state legislature, upon urgent recommendation of Governor Charles Evans Hughes, later Chief Justice of the United States Supreme Court, enacted the Public Service Commissions Law, which created two district commissions. These replaced four ineffectual bodies which had limited and vague powers of supervision over railroads, rapid transit, gas, and electricity.

The First District Commission, created by the 1907 law, was assigned

*For additional personal note, see "Pages with the Editors."

jurisdiction in New York city and the Second District in the balance of the state. Each district was an autonomous body, composed of five commissioners, with control within its territory over steam railroads, street railways, common carriers, gas, electricity, and grade-crossing eliminations. In 1910 the legislature brought under regulation telephone and telegraph companies with a property value of more than $10,000 under the jurisdiction of the Second District Commission. The same year the law was extensively revised to give the regulatory bodies greater authority over issuance of securities by utilities. Limited regulation was applied to bus lines in 1913. In 1921 the First and Second District commissions were combined into a single statewide board and a new organization, the transit commission, was created to supervise transportation utilities and grade-crossing eliminations in New York city.

THE decade of the twenties was a period of integration when scores of small utilities were fused into larger systems. This was followed throughout the thirties and early forties by further expansion of the duties and responsibilities of the commission as a result of legislative enactments. Utilities heretofore exempt from regulation were placed under the commission's jurisdiction.

Prior to 1930 the determination of the value of the utility property, which is basic in sound procedure for the fixation of rates and in capitalization matters, was not extensive because of staff limitations. In 1930 the state legislature established within the commission a bureau of research and valuation to carry on valuation work and to make special investigations. In the same year the legislature delegated to the commission the responsibility of promoting the extension of rural electrification throughout the state.

The following year the legislature placed under regulation all privately owned water companies, except those having a property value of $10,000 or less.

Beginning in 1931 and in subsequent years, the legislature extended the commission's duties with respect to the regulation of omnibus corporations and charged it with responsibility for adequacy of service and safety of operation of all vehicles having a capacity of more than seven persons used in public transportation. This included hundreds of busses operated by and for school districts.

THE State Constitutional Convention of 1938 and the implementing legislation of 1939 increased the commission's duties with respect to grade-crossing eliminations.

In New York city the transit commission had jurisdiction over grade-crossing elimination work, and had the duty of regulating bus companies and railroads. Thus, for example, the operations of the Long Island Railroad between the Pennsylvania station in Manhattan and Flatbush terminal in Brooklyn and points in Queens county were under supervision of the transit commission. In Nassau and Suffolk counties the company operated under jurisdiction of the public service commission. Several bus companies were in a similar situation.

In 1943, the legislature, upon recommendation of Governor Thomas E. Dewey, abolished the transit commission and transferred all of its work to the public service commission. Abolition of the transit commission and establishment of the public service commission as the sole statewide body with jurisdiction over all privately operated utilities eliminated the confusion and conflict bound to arise occasionally under dual regulation. It also resulted in substantial economies both to the utilities formerly under the dual setup and to the state.

With the steady expansion of the commission's functions, new units were established to handle the work. For example, in 1931 when waterworks corporations were placed under jurisdiction, a water bureau was organized with a staff of hydraulic engineers. In 1938 when motor carriers were placed under regulation, a motor carrier unit was established in the motor carrier bureau for the handling of the thousands of cases affecting the motor carrier industry. In other instances where the commission's duties with respect to utilities under jurisdiction were expanded, the work was integrated in the existing organization.

During the years of expansion of the work and duties of the commission, its staff increased from 267 employees in 1930 to 610 at the beginning of 1949.

Survey by State Budget Division

THE expanded scope of responsibilities, together with the increase in the staff, pointed up the necessity for changes in the organizational structure of the commission. There were fifteen divisions, bureaus, and subdivisions of groups of employees reporting directly to the commission. Because of overlapping functions, it became necessary, at times, to consult with two, three, and sometimes four different unit chiefs to obtain all information needed on a specific matter.

Clearly, the structural form of the organization did not keep pace with the growth in the duties and responsibilities of the commission. In the spring of 1949, after my appointment as chairman of the commission, I requested the director of the state budget to make a study of the organization and operations of the department. The object of the survey was to determine whether changes in the organization, methods, practices, and procedures were needed for better coordination of effort to achieve greater efficiency of operation.

Accordingly, the director of the budget assigned the administrative management bureau of the budget division to the task. Work on the survey began in October, 1949, and over a period of about eighteen months the budget experts studied directives of the commission, interviewed members

¶ "THE *public service commission of the state of New York underwent extensive reorganization in 1951. Out of the changes grew new procedures and functions designed to render greater and more expeditious service to the people and to the utilities subject to regulation.*"

of the staff, analyzed hundreds of procedures and functions, and reviewed records and forms.

The study led to the conclusion that the enlarged scope of the commission's work necessitated a more effective integration of its organizational structure. In some instances it was found that areas of responsibility were not clearly defined, resulting in overlapping jurisdictions and gaps in responsibility. The budget experts concluded that greater co-ordination of the diverse technical staff at a lower level than the commission was needed.

New Plan of Organization

IN May, 1951, the budget management bureau submitted to the commission a report with recommendations, calling for an organization, upon a functional basis, which includes an administration bureau, office of the counsel, office of public relations, a hearing bureau, a research bureau, and two main operating divisions, division of utilities and division of transportation. The commission adopted the reorganization plan, as shown in the accompanying chart, page 545.

Administration Bureau

TO a considerable degree the functions and responsibilities of existing units prior to adoption of the reorganization plans were left unchanged. Thus to the newly established administration bureau, which under the old organization was the office of the secretary, was assigned the responsibility of maintaining the records of the proceedings of the commission, the servicing and certification of orders, departmental "housekeeping" functions, such as finance, personnel, mail and supply, central files, printing and reproduction, and central stenographic service.

Office of Counsel

THE legal staff of the commission was organized as office of the counsel, with responsibility for litigation in all instances where the commission initiates action to enforce its orders or where the commission is defendant in proceedings brought by a utility to annul a decision of the commission.

The office of counsel also assumes the duty of protecting the public interest in formal proceedings before the commission, cross-examination of company witnesses on behalf of the public, preparation of orders, examination of company petitions, and formal complaints. The counsel also prepares recommendations for legislation as the need arises.

Office of Public Relations

THE office of public relations is responsible for the dissemination of information on the decisions and work of the commission. This involves analysis and interpretation of the decisions of the commission and the preparation of material for publication in newspapers and magazines and for radio broadcasts. The office of public relations also prepares the annual and various other reports of the commission.

Hearing Bureau

UNDER the old organizational structure the activities in processing a case to the point when it was ready for consideration and determination

Surveying Organization Needs

"A RESEARCH bureau was created to carry on basic studies of the operations and performance of various types of utilities under regulation for the purpose of establishing standards for regulation. This bureau also analyzes economic conditions and trends as they relate to utility regulation and functions. The research work of this unit is an important step in formulation of long-range policy in utility regulation."

by the commission in executive session were scattered in various units of the commission. Under the new plan a hearing bureau was organized as a staff unit to co-ordinate all procedures from the time the petition is filed by a company or when a proceeding is instituted by the commission on its own motion to the time when the case is ready for final action by the commission. This bureau has already increased the efficiency in the processing of formal cases before the commission and has brought about a greater consistency and uniformity of commission policy in deciding cases.

The hearing bureau is directed by two supervising hearing examiners, one directing the work of the bureau in the Albany office and another in the New York city office.

Research Bureau

A RESEARCH bureau was created to carry on basic studies of the operations and performance of various types of utilities under regulation for the purpose of establishing standards for regulation. This bureau also analyzes economic conditions and trends as they relate to utility regulation and functions. The research work of this unit is an important step in formulation of long-range policy in utility regulation.

Division of Utilities

THE survey by the budget experts pointed up the similarity of staff operations in the regulation of electric, gas, steam, telephone, and water utilities. The regulation of these types of companies requires co-ordination of the work of valuation engineers and accountants. To cope with these tasks, the division of utilities was created and embraces within its structure five units, to wit: the power bureau, telephone bureau, water bureau, general engineering bureau, and accounting bureau.

The director of the division of utili-

ties has the duty of supervision and co-ordination of the activities of these units. He assigns work in investigations in connection with formal cases and reviews the material prepared for hearings. He is also responsible for the proper execution of staff work in the light of the regulatory policies of the commission.

Functions of Units in Utilities Division

THE power bureau is concerned with the operations of gas, electric, and steam utilities; the telephone bureau has supervision over telephone and telegraph utilities, and the water bureau over privately operated water companies. Each of these bureaus has the responsibilities of making inspections and tests of plant and equipment for safe and adequate service; conducting engineering studies of efficiency of operation; analyzing tariff filings and proposed rates; performing valuation work as assigned by the director of utilities; presenting testimony in formal proceedings before the commission; ascertaining compliance by the utilities with commission orders; advising utilities on operational problems; and investigation of informal complaints.

The general engineering bureau is made up of valuation engineers. This bureau is designed as an engineering "pool" and engineers are assigned to operating bureau heads to perform valuation work. This permits the greatest possible flexibility in the efficient use of this type of personnel. This bureau works on specialized engineering projects.

The utilities accounting bureau has assigned to it all of the accounting work in the utilities division. This bureau makes examinations of the books and records of the utilities in rate cases, capitalization cases, mergers, consolidations, and property transfers in co-operation with other bureaus in the division. The bureau inspects books of the utilities to assure compliance with commission orders and provides accounting advice to utilities. The accounting bureau reviews the annual reports submitted to the commission by the utilities. This unit is also organized as a "pool" and accountants are temporarily assigned to the other bureaus in the utilities division. This organization pattern was devised to permit the maximum utilization of the accounting staff.

Division of Transportation

THE survey disclosed the desirability of integrating organizationally the regulatory functions concerned with transportation utilities. Proper integration of transportation facilities is of the utmost importance in the long-range planning for adequate transportation services.

The transportation division consists of three units: accounting and rates, motor carrier and railroad bureaus. The director of transportation has responsibility of administration and policy with respect to transportation.

The accounting and rates bureau performs assigned accounting and valuation studies of transportation utilities, examines all transportation tariffs, and develops data for rate cases. The personnel of this bureau may be assigned to the other bureaus to perform various technical assignments.

The motor carrier bureau is respon-

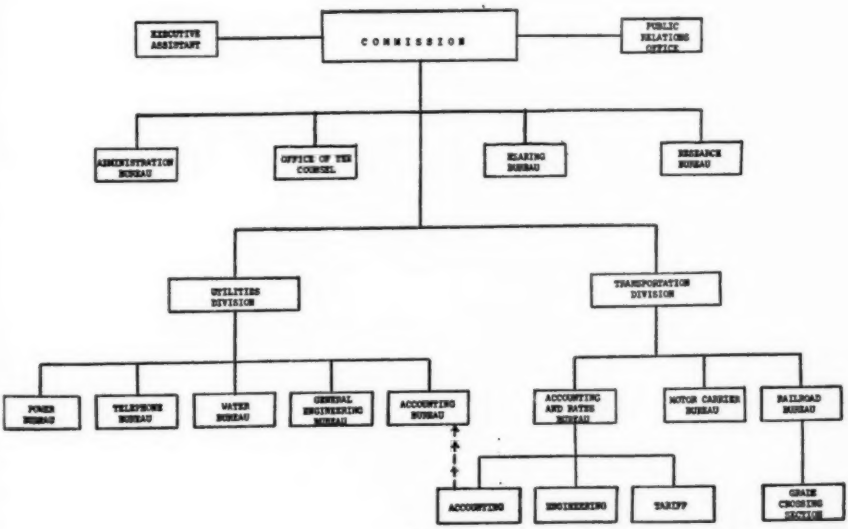
sible for the staff work in supervision of omnibus and motor truck companies. This bureau makes inspections of plant and equipment, studies efficiency of operation, and checks for compliance with commission orders. The bureau advises omnibus and motor truck companies on operating problems and investigates informal complaints by the public. It also prepares and presents testimony in formal proceedings.

The railroad bureau is concerned with the service and operations of railroads and grade-crossing elimination projects. This bureau is assigned the same operating responsibilities for railroads as the motor carrier bureau has for busses and trucks. The grade-crossing section reviews plans and prepares reports on matters pertaining to grade-crossing eliminations. It also makes determinations of the cost of improvements and the net benefits derived by railroads as a result of grade-crossing eliminations, for which the carriers must pay up to 15 per cent of the total cost of the project.

Offices of the Commission

THE principal office of the commission is in Albany, the capital city of the state. All petitions and applications by utilities under jurisdiction must be filed there. In addition, the commission has offices in New York city, covering the southeastern part of the state, and in Buffalo, for the extreme western part of the state. This setup provides an effective coordination for expeditious handling of cases. Two of the five commission-

PUBLIC SERVICE COMMISSION



ers have their principal offices in New York city and two are located in the Albany office, with one of the Albany commissioners making frequent visits to the Buffalo office for disposition of important matters affecting that area.

The chairman functions among the three offices, dividing his time between New York city and Albany, with occasional visits to Buffalo. The executive sessions of the commission are held alternately at the Albany and New York city offices, but the vast majority of orders implementing decisions of the commission are served from Albany.

Conclusion

THE members of the commission feel that the reorganized structure permits a high degree of efficient operation in the performance of the ever-increasing volume of work and in meeting the complex problems confronting a regulatory body in our time.

"HEY—where do I go to fix a pigeon's broken wing?" That's what an anxious bird lover recently asked of the Consolidated Edison Company of New York, Inc. It might have been a flight of fancy to ask an answer to that question by a public utility. But Bill Brady of Con Edison's public relations staff explained that, "For some unfathomable reason unknown to me, many New Yorkers think a public utility is a good place for the public to seek information. They feel we know everything. They have faith in us that way."

Once an artist, who had just painted a group of mammoth murals which depicted various sections of New York city after an atomic bomb blast, asked Con Edison to pay for a series of plates reproducing the tangled steel and cement jungle smoldering in flamboyant colors.

"The original murals would go to the United Nations," the artist carefully explained, despite the fact that the UN's world headquarters happens to be in the center of New York city.

But why should Con Edison foot the bill?

"It's a public service!" the artist insisted.

Pseudo-scientific do-gooders also come rapping on Con Edison's doors. To further its smoke abatement campaign, the utility once was advised, "Why don'tcha discharge the smoke under water—and purify it that way?"

Even Westinghouse researchers telephoned Con Edison once, asking "how many electric bulbs are being used in New York city—right now!"

Not only are the utilities asked questions, but so are the utilities' organizations. One of the more unusual requests recently was directed to the American Gas Association. A woman telephoned to say, "I'm going to Europe shortly and I'm going to bring along my portable radio, so what kind of electricity do they have in Europe—if I run out of batteries—and will I be able to listen to my favorite programs over there?"

But why ask a gas association about electricity? Perhaps it was because she paid her gas and electric bill to the same company and carried over the relationship to AGA—by association.

Investor Relations—An Important Aspect of Utility Management

It goes without saying that personalized investor relations are important to utility industries. Here is a brief but valuable and up-to-date account of what can be done to make groups of stockholders, particularly institutional investors and analysts, familiar with a given utility system operation.

By PAUL HALLINGBY, JR.*

DURING the postwar years, industry in general has become noticeably more conscious of the importance of favorable investor relations than was the case previously. This trend has been readily perceptible through some of the more conventional investor relations media, such as continually improving annual reports, initiation of interim reports to stockholders, and more interesting and, in some cases, more accessible annual meetings.

The public utility industry certainly has been an active participant in this constructive postwar trend, but in many instances the surface of this phase of management merely has been scratched. Our industry has all of the principal motives that other industries have for improving investor relations, plus certain others which apply primarily to public utility companies. These motivating factors, as they apply to the utility industry, may be summarized as follows:

1. The need for raising unprecedented sums of money for postwar utility plant expansion through public sale of securities at most favorable prices.

2. Recognition of competition for the investor's dollar with a great many other growing industries, most of which operate under conditions which generally are more advantageous to share owners during inflationary periods.

3. The need for educating the investing public as to the soundness, both financial and otherwise, of the utility industry today.

4. The need for enlisting the support of the investing and tax-

*For personal note, see "Pages with the Editors."

paying public in the investor-owned utility companies' fight to stem the continuing encroachment of the Federal government into the power business.

5. Realization that investor interest in securities of a given company depends upon not only the accomplishments of management but also the extent to which the investing public knows and appreciates these accomplishments.

6. Recognition of the importance of ownership of a utility company's shares in its service area, including ownership by employees and customers.

WITH these basic purposes in mind, the ingredients of an effective investor relations program for a typical public utility company may be examined. In doing so it is well to review at the outset certain fundamentals which are considered essential to such a program.

Of first importance it is necessary that the program evidence a desire to establish in the minds of investors the willingness on the part of management to disclose to and discuss frankly with investors the affairs and operations of the company as they might affect, sooner or later, its securities. This approach, when successfully carried out, is conducive to optimum investor confidence in management from the beginning. It is an approach which should present no obstacle to utility companies, accustomed as they are to the "fish-bowl" type of existence that results from their activities involving various regulatory bodies, frequent issuance of registration statements in compliance with the Securities Act, and so on. Still, qualified utility security analysts often come away from the executive offices of a public utility company complaining over management's apparent unwillingness to discuss openly and frankly certain aspects of the company's operations.

ANOTHER essential of an investor relations program is recognition of the significance of the current trend toward institutionalization of personal savings. It is well known that in recent years there has been a growing tendency for personal savings to be funneled into financial institutions, such as life insurance companies, savings banks, investment companies or mutual funds, pension funds, etc. Some utility companies have found that investors of this type already represent ownership of substantial amounts of their common stock in addition to large percentages of their preferred stocks and debt securities. The increasing importance of this investor group as a source of capital funds for public utility and other companies should be of considerable influence in shaping the investor relations program.

A final requisite of such a program is acceptance of the importance of brokerage firms, security dealers, and investment bankers to public utility companies. These firms are in personal contact with both institutional investors and present and potential individual security buyers throughout the country. They are the opinion leaders in our financial communities; they guide investment thinking. This appears to be particularly significant in the field of public utilities, in which

security analysis has reached a relatively advanced stage.

It was mentioned above that the public utility industry, like others, generally has utilized in recent years the more conventional means of improving investor relations. These include more informative and enlightening annual reports, quarterly or other interim reports to stockholders, and more stimulating annual meetings, supplemented in some cases by regional meetings of stockholders. These various facets of investor relations are basic and, needless to say, require constant attention on the part of management in order to retain and improve their effectiveness.

But, taken alone, these media fall far short of the mark. They provide the groundwork for a successful investor relations program. They reach the point where the more impersonal part of a well-conceived program stops and the more personal, and generally more productive, part of the program starts.

An essential part of the more personalized portion of an investor relations program is appearances by top company executives before groups of investment officers and security analysts of financial institutions and other firms that represent investors and stockholders (such as brokers, dealers, investment counselors, trust companies, etc.). A great many utility company presidents have appeared before the New York Society of Security Analysts. Having been well received by this important group, many have accepted invitations for return appearances. But perhaps all too many utility companies limit this type appearance to New York or to the leading financial community in their service area.

There are in this country (and also in Canada) numerous other societies of security analysts in cities which are important contributors to the capital market. These groups welcome appearances by top company officials. Many of the important financial communities do not have analysts' societies or other groups before which company officials can appear conveniently. Yet, an enterprising management can arrange informal meetings in such cities with groups of investors and analysts representing local financial institutions and investment houses, as well as certain individual stockholders.

Carrying this type of personalized investor relations a step further, company officers, when visiting other cities on business, may find it advan-

¶ "Appearances *before groups of stockholders, investors, and analysts, whether formal or informal, together with personal calls by company officers, not only provide management an excellent opportunity to speak directly and frankly of the company's accomplishments. They also provide management an effective means of making known to investors its willingness to discuss with them its operations and problems.*"

tageous to call upon stockholders or firm representing stockholders or investors in that area.

Appearances before groups of stockholders, investors, and analysts, whether formal or informal, together with personal calls by company officers, not only provide management an excellent opportunity to speak directly and frankly of the company's accomplishments. They also provide management an effective means of making known to investors its willingness to discuss with them its operations and problems. Moreover, they serve to establish a lasting two-way contact between management and the investor, which can be continued by telephone and correspondence. Finally, they afford a chance for expanding a company's all-important mailing list for its publications for stockholders and investors.

ANOTHER useful form of personalized investor relations, which is growing in popularity in our industry, is the field trip over a company's service area. Security analysts in particular seem to appreciate improving their "feel" of a given company's operations by seeing its territory firsthand.

Field trips which have been spoken of with special favor are those which do not place primary emphasis on inspecting the company's generating stations and other physical property, but rather stress observation of territorial development and meeting and talking with people in the area. These include company personnel, local businessmen and customers, public service commissioners, and other local government administrators.

In addition to conducting field trips for those analysts concerned primarily with public utility securities, a few companies have found it beneficial to tour their service areas with top officers of investing institutions, investment banking and brokerage houses, commercial banks, and the like. Men of this stature exert considerable influence on investment decisions through their participation in policy matters coming before investment committees and investment banking syndicates (in the case of new security issues). Also, they frequently may be in a position to advise on the matter of selecting a geographical location for a proposed new industrial plant or plant addition.

ANOTHER important part of a successful investor relations program concerns achieving a friendly and co-operative relationship with the financial press. It is desirable that newsworthy items affecting the company receive proper attention in the financial press, to which investors, both professional and otherwise, turn for information. Participation of financial writers in field trips over a company's service area has been found helpful in this connection.

One form of personalized communication from management to all stockholders, large or small, is the so-called "stockholder welcome letter," sent to each new stockholder in whose name a company's shares are registered. While a letter of this type can be justified on the basis of good taste alone, it also serves to signify management's interest in the stockholder. Furthermore, it is indicative that management is alert in taking notice of

Purpose of Investor Relations Program

"THE need of an effective investor relations program on the part of every investor-owned public utility company is particularly important because of the continuing requirement of our industry for private capital to finance the facilities needed to meet this country's growing demand for energy. It is also important because of the need of our industry to keep the investing and tax-paying public informed of our defense against those political forces which seek to socialize the power business."

the addition of new members to the company's team.

ONE phase of a power company's investor relations program relates to the desirability of broadening ownership of the company's common shares in its service area. Local ownership can be very advantageous. It serves to keep more local people informed of the company's accomplishments and problems. It encourages their assisting the company, if by no other means than adding their voice to local public opinion, in supporting the investor's interest in rate cases or other matters before regulatory commissions, problems regarding franchises or renewals, securing of new industrial customers in the territory, and conflicts with politically managed power projects in or near the service area.

LOCAL ownership of a public utility company's stock can be encouraged by various means. One is adept handling of relationships with the local press. Another is enlisting the confidence and co-operation of security dealers in the service area or its nearest financial center, particularly in cases where the stock is traded in the over-the-counter market. Where the stock is listed on a leading national exchange, listing it also on the local or nearest regional stock exchange may prove helpful.

Stock ownership by company employees is particularly desirable in this connection. Employee stock purchase plans are effective, of course, but in a great many cases these are not permitted under existing regulatory procedures. A few companies, not having formal plans of this type, have found it possible to make pref-

erential offerings of new common stock to their employees. One company recently made a preferential offering of new shares to residents of the state in which it operates.

THE need of an effective investor relations program on the part of every investor-owned public utility company is particularly important because of the continuing requirement of our industry for private capital to finance the facilities needed to meet this country's growing demand for energy. It is also important because of the need of our industry to keep the investing and tax-paying public informed of our defense against those political forces which seek to socialize the power business. But even if these two strong influences should subside, the continuation of an active investor relations program can surely be justified on the basis of sound business policy under the free enterprise system.

It is hoped that the ends and means presented herein will serve to stimulate more thinking on the part of utility management about the importance of favorable investor relations.

Profits Provide Jobs

"PROFITS *are the pay that investors get for the use of their money. The money people have invested in our business buys trucks, switchboards, poles, typewriters, desks, buildings, climbing irons, billing machines, headsets, and all the other things that must be provided in order for us to have jobs. There is $19,000 invested in such things for each of us.*

"Why do people invest their money in a business? For just one reason. To get more money—in the form of dividends on stock or interest on bonds. If they don't feel reasonably sure that their money will earn more money for them in the telephone business, they'll invest it elsewhere. Wouldn't you?

"The matter of the company making a profit is of direct, individual, personal concern to each of us—not just a headache for the top brass. It's not enough that we get enough money from our customers just to get by—to pay wages and benefits, to buy supplies, to provide for plant wearing out—to meet all the other expenses of running a business, including that big tax bill. If we just make ends meet—and no more—we won't be able to even make ends meet very long. We must have more people constantly investing more money in our business, if we are to stay in business—if we are to keep on providing good jobs for good people. We must make profits to do that—we must always earn a reasonable amount over and above what it takes just to run the business."

—EDITORIAL STATEMENT,
Telephone News, published by the Bell Telephone Company of Pennsylvania.

Financial News and Comment

By OWEN ELY

A Banker's Views on Regulation And Rate of Return

On September 24th the New York Society of Security Analysts held a forum on "Utility Rate of Return from the Investor's Viewpoint." The speakers were Dr. James C. Bonbright, professor of finance at Columbia University; James A. Lyles, vice president of The First Boston Corporation; and Dr. Alexander Sachs, economist. Charles Tatham, Jr., vice president of Institutional Utility Service, Inc., was chairman of the meeting. The views expressed by Mr. Lyles are of special interest, since they represent the viewpoint of a leading merchandiser of utility securities, who feels that rate of return is a vital factor in the program of utility financing.

DEPARTMENT INDEX

In his talk he concentrated on the problem of selling common stock, since the historical cost of selling senior securities for a given company at a given time is easily available in the records. "The sale of common stocks," he remarked, "is a different matter. Here we are dealing with by far the most volatile and expensive segment of the capital structure. Since common stock and surplus includes retained earnings and in most cases surplus has been subject to adjustments, the historical cost of such money is difficult or impossible to obtain. How about the present cost? . . .

"What we are interested in is what it takes to sell common stocks of utilities under average conditions on a reasonable basis—that is, a basis which is fair to the already existing stockholders of the company, reasonable in the sense of cost of money to the issuing company under the conditions prevailing at the time of sale, and adequate in the sense that enough can be sold at a price which will maintain the stability of the capital structure of the company. . . . Under generally favorable market conditions such as the present, the price should be substantially in excess of book value." Sale of common stock *below* book value would, he declared, impair the interests of existing stockholders. These conclusions were based on the assumption that the utility is typical in character, with the plant account stated at original cost (plus acquisition adjust-

ments, if any), and with an equity ratio of 30-35 per cent.

Buyers of common stocks want (1) adequate yield in relation to yields provided by other investment media, (2) assurance of dividend stability during depressions, and (3) a gradual (but not spectacular) increase in earnings and dividends as a reward for the plow-back of undistributed earnings. While there may be temporary irregularities in share earnings due to issuance of additional shares, etc., "a potential stockholder wants to know that he is buying into a situation which is not going to deteriorate in his face. Anticipation of increased earnings and, ultimately, of increased dividends is most helpful in obtaining a good price for utility stocks."

INVESTORS would prefer to pay more than book value, Mr. Lyles suggested, because if a stock were selling below book value this would seem to indicate that either the management is dilatory or that it was unable to obtain reasonable regulatory treatment. The investor expects the management to seek rate increases when necessary in order that the *additional* investment in the plant will provide earnings at a reasonably consistent rate.

As of August 20, 1952, he stated that the average market value of 93 electric utility stocks was 137 per cent of their average book value. These companies had an average capital structure (on an arithmetical basis of compilation) of 52 per cent debt, 14 per cent preferred stock, and 34 per cent common stock. The average return on capitalization approximated 6 per cent—3.4 per cent on debt, 4.5 per cent on preferred stock, and 10.5 per cent on common stock book value (the latter figure being equivalent to a 7.7 per cent earnings-price ratio).

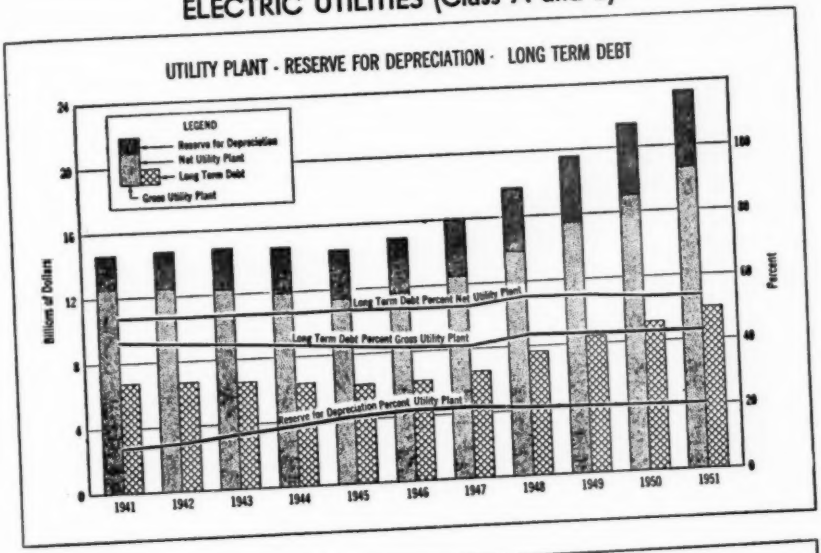
Mr. Lyles stated, however, that he did not think that this necessarily meant that a 6 per cent return on capitalization is adequate. "I believe that the common stocks of utilities are currently selling at prices which are discounting continued growth and are also the beneficiaries of certain new markets which, at least for the time being, have created an unusual demand for this type of investment. These are the mutual funds, pension funds, and certain savings banks. I am disturbed lest investors in utility commons may not yet have fully recognized the adverse long-term effects of the reduced purchasing power of the dollar and the impact of high individual income taxes on their dividend income. . . .

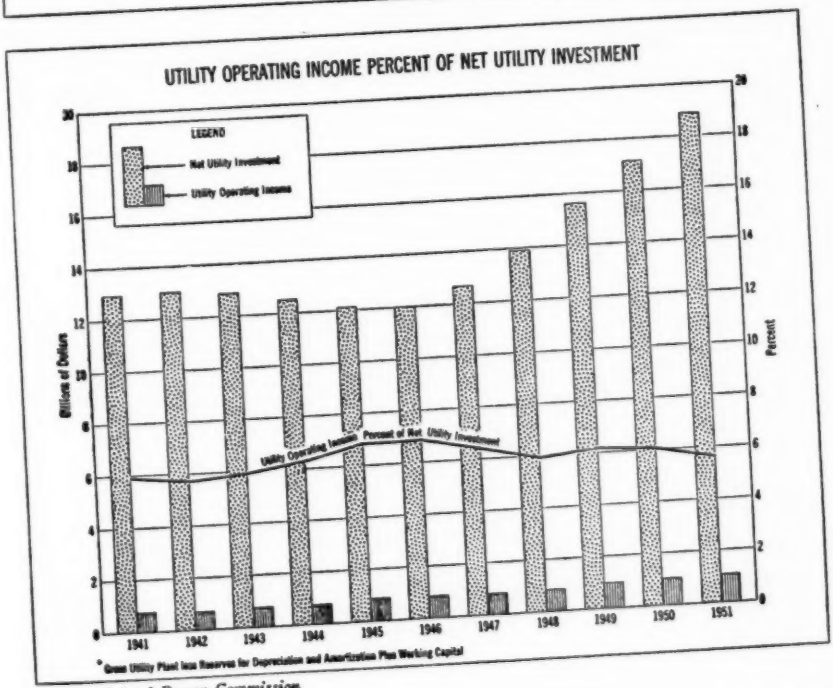
*UTILITY NEW MONEY FINANCING
(In Millions)

	Sept.	*Nine Months*	*% Increase Over 1951*
Electric Utilities			
Bonds	$ 75	$ 850	37%
Preferred	21	170	310
Common	24	366	30
	$120	$1,386	45%
Gas Utilities			
Bonds	$ 70	$ 335	D30%
Preferred	3	87	163
Common	—	75	23
	$ 73	$ 497	D14%
Total	$193	$1,883	24%

*As compiled by the Irving Trust Company.

ELECTRIC UTILITIES (Class A and B)





Source, Federal Power Commission

"Were the investing public, including the new sources of investment money, to believe that earnings would not keep pace with increased investment, we would promptly find earnings-price yields going up and rate of return calculated on that basis doing the same thing. The meat in the coconut to me is simply that each individual company must be provided with enough dollars of earnings to enable it, in the light of its own cash requirements and particular circumstances, to continue to raise its common stock money at an appreciable premium over book value."

MR. LYLES urged that when rate increases are necessary to maintain the rate of earnings they should be promptly sought by the management and promptly granted by the commission. Delays by the regulatory authorities reflect an inexcusable failure to do their statutory duty and are likely to result in materially impaired market prices for utility stocks. In this connection some provision should be adopted by the commissions which would permit temporary increases (not niggardly) which would be subject to later detailed review. Moreover, such increases should be in such form that they would reflect *real* earnings —not put into effect under bond or some other method of withholding. The lag in securing increases nearly always means a permanent or at least a long-term loss to investors.

Moreover, during the current period of heavy construction programs the commissions should grant rate increases in the light of near-term financing requirements. Construction expenditures, revenues, and expenses can be projected with reasonable accuracy for at least a year or so ahead, and where these estimates indicate that rate increases will prove necessary to support the program, they should be granted. The problem of financing would be materially eased where commissions are willing to study these projections and anticipate the need for higher rates.

"Failure of the utilities to be allowed to maintain a fair earning power," Mr. Lyles concluded, "will ultimately result in investors turning from their utility securities. And when the investors want 'out' they will want it quick. After that occurs, if it does, both regulation and management will have an extremely difficult time putting Humpty Dumpty back again."

Would Termination of EPT Next June Be Bearish for Utilities?

THE provision of the present tax law providing for excess profits taxes will expire next June, and no less an authority than Secretary of the Treasury Snyder has indicated his view that this controversial and hard-to-administer tax may be allowed to die at that time. Since it brings in several billion dollars of revenue to the Treasury (the exact amount is somewhat difficult to estimate), the lost revenues will doubtless have to be made up by some other method. Wall Street's guess appears to be that this will involve a further increase in the regular corporate tax rate, which now stands at 52 per cent (normal and surtax combined).

Elimination of EPT would doubtless prove a boon to some industrial groups[1] but how will the utilities be affected? The present excess profits provisions were hand tailored by Congress to avoid an undue burden on the utilities, so that they would not be handicapped in their tremendous construction and financing program. Only two of the larger gas companies (Northern Natural Gas and Southern Natural Gas) paid small amounts of EPT last year; and only about one-fifth of the electric utilities had to pay this tax, generally in small amounts in relation to share earnings. The 15 or 20 electric utilities which did pay the tax will probably benefit by the change-over (though some of them might be able to avoid the tax anyway

[1] See the 23-page bulletin issued by Merrill Lynch, Pierce, Fenner & Beane, "Impact of the Excess Profits Tax."

in 1952 and later years, if accelerated amortization is available for tax reduction).

On the other hand, the remaining 80 per cent of the electric utilities would be hurt by an increase in the regular corporate tax rate.

So far, the threat of higher taxes has not apparently become a market factor, as utilities at this writing (October 7th) remain close to their best levels of recent years. But industrial people are beginning to concern themselves with the question, with a view to appropriate protective steps which might be taken when the next tax bill is under consideration by Congress.

New Prospectus Rules Remove Selling Uncertainties

COMMISSIONER Clarence H. Adams of the SEC has hailed the recently revised prospectus regulations (Rule 132) as one of the most outstanding steps taken by the commission in recent years. Pointing out that the Securities Act con-

PRINCIPAL PUBLIC OFFERINGS OF ELECTRIC AND GAS UTILITY SECURITIES
July 1, 1952, to September 30, 1952

Date	*Amount Mill.*	*Description*	*Price To Public*	*Underwriting Spread*	*Offering Yields*	*Moody Rating*
		Mortgage Bonds & Debentures				
7/10	$20.0	Georgia Power 1st 3⅜s 1982	101.04	.62	3.32	A
7/16	40.0	Commonwealth Edison 1st 3¼s 1982 .	101.93	.24	3.15	Aaa
8/ 7	9.5	Pennsylvania Electric 1st 3⅜s 1982 ..	100.47	.36	3.35	A
9/ 9	40.0	Tennessee Gas Trans. 1st 3⅜s 1972 ..	101.75	.85	3.75	A
9/11	15.0	Arkansas Power & Lt. 1st 3⅜s 1982 ..	100.93	.72	3.45	A
9/24	14.0	Duquesne Light 1st 3⅛s 1982	102.42	.46	3.13	Aaa
9/24	7.5	Pacific Power & Light 1st 3⅜s 1982 .	101.81	.41	3.65	Baa
9/25	17.0	Appalachian Elec. Power 1st 3¼s 1982	102.25	.68	3.38	A
9/25	6.0	Appalachian Elec. Power 3¼% Serial Notes due 1956-67	101.17	.41	3.00–3.48	Baa
9/25	5.0	Central Ill. Pub. Serv. 1st 3⅛s 1982 ..	101.50	.39	3.42	A
		Preferred Stocks				
7/10	$ 5.0	Pub. Serv. of New Hampshire 5.40%	102.85	2.65	5.25	
7/23	5.0	Gulf States Utilities $4.44	102.75	2.09	4.32	
7/29	10.0	Pennsylvania Power & Light 4.40%	100	2.25	4.40	
8/ 7	4.5	Pennsylvania Electric $4.50	102.27	1.94	4.40	
8/21	19.0	Texas Eastern Transmission 5.50% .	100	3.50	5.50	
9/ 2	3.0	Houston Natural Gas 5% ($25 Par)	25	*	5.00	
9/17	7.0	Duquesne Light 4.15% ($50 Par) ..	51.23	1.07	4.05	
9/18	9.0	Columbus & So. Ohio Electric 4.65%	100	2.25	4.65	
9/25	5.0	Central Illinois Pub. Service 4.92% .	102.50	1.94	4.80	
		Common Stocks—Subscription Rights				*Earnings-Price Ratio*
7/ 2	$ 6.2	Florida Power Corp.	20b	**	6.00%	6.5%
7/ 2	11.2	General Public Utilities	21	a	6.67	8.4
7/ 8	3.0	Washington Gas Light	29	.53	6.21	7.6
9/ 6	4.8	Utah Power & Light	28.75b	a	6.26	7.5
9/25	9.3	Long Island Lighting	15.50	.20	5.81	7.5
9/26	3.1	Iowa Public Service	21	—	6.67	7.8
		Common Stocks—Other New Money Sales				
8/13	$ 2.6	Mountain States Power	12.88	.18	6.52%	8.0%
8/13	6.1	Texas Gas Transmission	17.38	.90	5.76	8.0
9/18	7.5	Columbus & So. Ohio Electric	24.88	1.00	5.63	7.4

*Offered by subscription. **Special basis for underwriters' commissions. a—Compensation to dealers. b—Oversubscriptions allowed.

templates that investors will read the prospectus before deciding whether to purchase registered securities, he stated in a recent address:

> The plain fact is, as we all know, that the prospectus . . . commonly gets into the investor's hands for the first time along with the confirmation of sale, or with the certificate itself, and too late to serve the main purpose for which it was intended.

CURRENT UTILITY STATISTICS AND RATIOS

	Unit Cost	*Latest Month*	*Latest 12 Mos.*	*Per Cent Increase Latest Month*	*Per Cent Increase Latest 12 Mos.*
Operating Statistics (August)					
Output KWH—Total	Bill. KWH	34.4	388.5	6%	8%
Hydro-generated	"	8.5	—	9	—
Steam-generated	"	25.9	—	7	—
Capacity	Mill. KW	78.3	—	—	7
Peak Load (July)	"	64.5	—	7	—
Fuel Use: Coal	Mill. Tons	8.6	—	D4	—
Gas	Mill. MCF	105.0	—	19	—
Oil	Mill. Bbls.	5.4	—	5	—
Coal Stocks	Mill. Tons	42.1	—	13	—
Customers, Sales, Revenues, and Plant (July)					
KWH Sales—Residential	Bill. KWH	4.8	61	15	13
Commercial	"	4.3	47	12	10
Industrial	"	10.3	137	D4	5
Total, Incl. Misc.	"	26.0	324	4	6
Customers—Residential	Mill.	30.6	—	4	—
Commercial	"	4.4	—	2	—
Industrial	"	.5	—	3	—
Total	"	37.8	—	4	—
Income Account—Summary (July)					
Revenues—Residential	Mill. $	143	1,743	13	11
Commercial	"	113	1,265	11	8
Industrial	"	121	1,525	1	6
Total, Inc. Misc. Sales	"	417	4,987	8	8
Sales to Other Utilities	"	34	404	14	3
Misc. Income	"	8	218	18	7
Expenditures—Fuel	"	72	878	5	8
Labor	"	93	1,047	12	8
Misc. Expenses	"	69	811	7	1
Depreciation	"	40	490	1	7
Taxes	"	94	1,198	6	12
Interest	"	26	298	12	10
Amortization, etc.	"	.3	16	D85	D30
Net Income	"	65	873	15	9
Pref. Div. (Est.)	"	10	123	5	6
Bal. for Common Stock (Est.)	"	55	750	20	11
Com. Div. (Est.)	"	5	196	Infinite	61
Bal. to Sur. (Est.)	"	50	554	13	7
Electric Utility Plant (July)	"	21,712	—	10	—
Reserve for Depreciation and Amort.	"	4,430	—	8	—
Net Electric Utility Plant	"	17,282	—	10	—
Life Insurance Investments (January 1st-September 27th)					
Utility Bonds	"	—	501	—	D6
Utility Stocks	"	—	56	—	60
Total	"	—	557	—	D2
% of All Investments	"	—	7%	—	9

This condition has resulted from the fact that, while the law provides a "waiting period" during which information contained in the registration statement is supposed to be disseminated to dealers and investors in order that they may make an anlysis of the worth of the securities in advance of their commitment to purchase, it also contains a prohibition against any selling activities during such period.

This has created confusion in the minds of underwriters and dealers as to what constitutes permissible dissemination of information on the one hand, and prohibited selling activity on the other.

THE new rule, Commissioner Adams points out, is designed to remove these doubts by permitting underwriters and dealers, for the first time, to advertise the security during the waiting period by means of a so-called "identifying statement" which will give certain limited information about the security and invite requests for copies of the proposed prospectus. In order that the prospectus may be informative to the investor, the commission also will insist that it be "reasonably concise and readable"—a goal not always achieved in the past.

Utility Material in the Paley Report

THE report to the President by the so-called Paley Commission (the President's Materials Policy Commission, headed by William S. Paley, board chairman of Columbia Broadcasting System, Inc.), was published in five substantial volumes in June. It contains a wealth of material for the business executive, and some sections are of special interest to the utility industry. Thus in Volume I, Chapter 18 discusses natural gas, and Chapter 20 electricity, while Chapters 21 and 22 cover such topics as "Energy for Other Free Nations" and "Changes in the Energy Pattern." In Volume III, Chapter 2 relates to natural gas and Chapter 4 covers "Electric Energy," which is especially interesting in its discussion of potential hydro development.

FINANCIAL DATA ON ELECTRIC UTILITY STOCKS

1951 Rev. (Mill.)			*10/1/52 Price About*	*Div. Rate*	*Current Yield*	*Share Earnings* Cur. Period*	*% Increase*	*12 Mos. Ended*	*Price-Earns. Ratio*	*Div. Payout*
$193	S	American Gas & Elec. ...	60	$3.00	5.0%	$4.60**	D5%	Aug.	13.0	65%
22	O	Arizona Public Service ..	15	.80	5.3	1.10	51	Aug.	13.6	73
6	O	Arkansas Mo. Power	17	1.00	5.9	1.34	5	June	12.7	75
20	S	Atlantic City Elec.	26	1.30	5.0	1.76	4	Aug.	14.8	74
4	O	Bangor Hydro-Elec.	27	1.60	5.9	2.21	4	June	12.2	72
2	O	Beverly G. & E.	52	3.70†	7.1	4.13	31	Dec.	12.6	97
3	O	Black Hills P. & L.	21	1.28	6.1	1.73	D6	June	12.1	74
74	B	Boston Edison	51	2.80	5.5	3.39	13	June	15.0	83
13	C	California Elec. Pr.	10	.60	6.0	.83	54	June	12.0	72
12	O	Calif. Oregon Pr.	26	1.60	6.2	1.95	4	Aug.	13.3	82
40	S	Carolina P. & L.	39	2.00	5.1	2.92	7	Aug.	13.4	68
18	S	Cen. Hudson G. & E.	12	.70	5.8	.85	44	June	14.1	82
14	O	Central Ill. E. & G.	26	1.30	5.0	2.22	3	June	11.7	59
22	S	Central Ill. Light	39	2.20	5.6	2.73	D7	Aug.	14.3	81
33	S	Central Ill. P. S.	20	1.20	6.0	1.51	D2	June	13.2	79
8	O	Cent. Louisiana Elec. ...	36	2.00	5.6	2.80	10	June	12.9	71
24	O	Central Maine Power ...	19	1.20	6.3	1.52	15	Aug.	12.5	79
80	S	Central & S. W.	20	1.00	5.0	1.48	11	June	13.5	68
8	O	Central Vermont P. S. ..	14	.80	5.7	1.21**	33	Aug.	11.6	66
77	S	Cincinnati G. & E.	40	2.00#	5.0	2.86	4	June	14.0	70
5	O	Citizens Utilities	14	.36#	5.6a	.83	20	June	16.9	43
80	S	Cleveland Elec. Illum. ...	54	2.60	4.8	3.93	11	June	13.7	66
2	O	Colorado Cent. Power ...	18	1.00	5.6	1.26	D1	June	14.3	79

1951 Rev. (Mill.)		(Continued)	10/1/52 Price About	Div. Rate	Current Yield	Share Earnings* Cur. Period	% Increase	12 Mos. Ended	Price-Earns. Ratio	Div. Pay-out
31	S	Columbus & S. O. E.	25	1.40	5.6	2.16	13	June	11.6	65
281	S	Commonwealth Edison ..	34	1.80	5.3	2.10	D1	June	16.2	86
7	C	Community Pub. Ser. ...	20	.90	4.5	1.51	31	June	13.2	60
1	O	Concord Electric	35	2.40	6.9	2.52	D5	Dec.	13.9	95
48	O	Connecticut L. & P.	16	.88†	5.5	.98**	D1	Aug.	16.3	90
16	O	Connecticut Power	38	2.25	5.9	2.38	D3	June	16.0	95
418	S	Consol. Edison	37	2.00	5.4	2.23	2	June	16.6	90
84	S	Consol. Gas of Balt.	26	1.40	5.4	1.66	D2	June	15.7	84
129	S	Consumers Power	37	2.00	5.4	2.72	2	Aug.	13.6	74
49	S	Dayton P. & L.	36	2.00	5.6	2.59	—	June	14.3	77
23	S	Delaware P. & L.	26	1.20	4.6	1.63	D15	June	16.0	74
6	O	Derby G. & E.	22	1.40	6.4	1.45	D30	Dec.	15.2	97
164	S	Detroit Edison	24	1.40	5.8	1.63	3	Aug.	14.7	86
89	C	Duke Power	91	4.00	4.4	6.87	D6	June	13.2	58
7	O	El Paso Electric	23	1.20	5.2	1.84	4	Aug.	12.5	65
9	S	Empire Dist. Elec.	24	1.40	5.8	2.29	22	June	10.5	61
4	O	Fitchburg G. & E.	49	3.00	6.1	3.12	D15	Dec.	15.7	96
25	S	Florida Power Corp.	22	1.20	5.5	1.70	28	June	12.9	71
55	S	Florida P. & L.	31	1.40	4.5	2.54	6	June	12.2	55
137	S	General Pub. Util.	25	1.40	6.4	1.98	13	June	12.6	81
5	O	Green Mt. Power	19	1.20	6.3	1.74	D11	Aug.	10.9	69
33	S	Gulf States Util.	25	1.20	4.8	1.76	18	Aug.	14.2	68
18	C	Hartford E. L.	48	2.75	5.7	2.72	D5	June	17.6	101
4	O	Haverhill Electric	33	2.40†	7.3	2.59	D17	Dec.	12.7	93
41	S	Houston L. & P.	24	1.00	4.2	1.58	18	Aug.	15.2	63
17	S	Idaho Power	40	1.80	4.5	3.10	22	June	12.9	58
51	S	Illinois Power	39	2.20	5.6	2.79	D6	Aug.	14.0	79
31	S	Indianapolis P. & L.	39	2.00	5.1	2.86	—	June	13.6	70
15	S	Interstate Power	10	.60	6.0	.77	12	June	13.0	78
16	O	Iowa Elec. L. & P.	18¼	1.10	5.9	1.59	10	Aug.	11.6	69
24	S	Iowa-Ill. G. & E.	28	1.80	6.4	2.13	D8	June	13.1	85
25	S	Iowa Power & Light	25	1.40	5.6	1.66	—	June	15.1	84
22	O	Iowa Pub. Service	22	1.40	6.4	1.84	3	Aug.	12.0	76
9	O	Iowa Southern Util.	18	1.20	6.7	1.29	9	Aug.	14.0	93
36	S	Kansas City P. & L.	30	1.60	5.3	2.05	24	Aug.	14.6	78
16	O	Kansas Gas & Elec.	35	2.00	5.7	2.55	4	Aug.	13.7	78
29	S	Kansas Pr. & Lt.	19	1.12	5.9	1.34	D4	June	14.2	84
27	O	Kentucky Utilities	17	1.00	5.9	1.49	D1	June	11.4	67
5	O	Lake Superior D. P.	31	1.80	5.8	2.73	11	Mar.	11.4	66
6	O	Lawrence G. & E.	33	1.90†	5.8	2.65	D15	Dec.	12.5	91
53	S	Long Island Lighting	17	.90	5.3	1.31	32	June	13.0	69
35	S	Louisville G. & E.	39	1.80	4.6	3.08	10	June	12.7	58
6	O	Lowell Elec. Lt.	47	3.35†	7.1	3.70	D7	Dec.	12.7	91
8	O	Lynn G. & E.	29	1.60	5.5	1.56	D26	Dec.	18.6	103
6	O	Madison G. & E.	34	1.60	4.7	2.47	7	Dec.	13.8	65
3	C	Maine Public Service	18	1.20	6.7	1.48	12	July	12.2	81
3	O	Michigan G. & E.	31	1.80	5.8	2.80	6	June	11.1	64
112	S	Middle South Util.	26	1.30	5.0	1.93	24	Aug.	13.5	67
17	S	Minnesota P. & L.	36	2.20	6.1	3.07	D5	Aug.	11.7	72
1	O	Missouri Edison	11	.70	6.4	1.16	1	June	9.5	60
6	C	Missouri P. S.	21	1.00	4.8	1.56	D9	Dec.	13.5	64
5	O	Missouri Utilities	17	1.00	5.9	1.56	D7	June	10.9	64
27	S	Montana Power	28	1.55†	5.5	2.41	—	July	11.6	64
13	C	Mountain States Pr.	14	.84	6.0	1.22	3	June	11.5	69
105	S	New England Elec.	14	.90	6.4	1.15	—	June	12.2	78
34	O	New England G. & E.	15½	1.00	6.5	1.21**	D3	Aug.	12.8	83
38	O	New Orleans P. S.	40	2.25	5.6	2.64	D5	Aug.	15.2	85
2	O	Newport Electric	30	2.00	6.7	2.60	3	July	11.5	77
57	S	N. Y. State E. & G.	34	1.90	5.6	2.36	39	Aug.	14.4	81
176	S	Niagara Mohawk Power	27	1.60	5.9	1.98	31	July	13.6	81
89	S	North American	22	1.20	5.5	1.36	3	June	16.2	88
51	O	Northern Ind. P. S.	27	1.52	5.6	2.20	—	Aug.	12.3	69
89	S	Northern States Pr.	12	.70	5.8	.88	10	June	13.6	80

Div. Pay-out	1951 Rev. (Mill.)		(Continued)	10/1/52 Price About	Div. Rate	Current Yield	Share Earnings* Cur. Period	% Increase	12 Mos. Ended	Price-Earns. Ratio	Div. Pay-out
65	8	O	Northwestern P. S.	13¼	.90	6.7	1.25	D3	June	10.8	63
86	96	S	Ohio Edison	36	2.00	5.6	2.77	2	Aug.	13.0	72
60	29	S	Oklahoma G. & E.	26	1.40	5.4	1.80	15	June	14.4	78b
95	13	O	Otter Tail Power	23	1.50	6.5	1.76	D5	Aug.	13.1	85
90	279	S	Pacific G. & E.	36	2.00	5.6	2.40**	8	June	15.0	83
95	20	O	Pacific P. & L.	19	1.10	5.8	1.71	32	Aug.	11.1	64
90	85	S	Penn Power & Light	31	1.60	5.2	2.48	6	Aug.	12.5	65
84	7	C	Penn Water & Power	42	2.00	4.8	2.24	—	Dec.	18.8	89
74	165	S	Philadelphia Elec.	31	1.50	4.8	2.18	5	June	14.2	69
77	25	O	Portland Gen. Elec.	31	1.80	5.8	2.43	6	Aug.	12.8	74
74	43	S	Potomac Elec. Power	17	1.00	5.9	1.34	35	July	12.7	75
97	49	S	Pub. Serv. of Colo.	29	1.40	4.8	2.06	D4	June	14.1	68
86	201	S	Pub. Serv. E. & G.	26	1.60	6.2	2.11	NC	Mar.	12.3	76
58	50	S	Pub. Serv. of Ind.	34	1.80	5.3	2.40	21	Aug.	14.2	75
65	17	O	Public Serv. of N. H.	27	1.80	6.7	1.97	35	Aug.	13.7	91
61	7	O	Public Serv. of N. M.	10	.56	5.6	.83	2	June	12.0	67
96	21	O	Puget Sound P. & L.	23½	.80	3.4	1.63	D8	June	14.4	49
71	38	S	Rochester G. & E.	38	2.24	5.9	2.74	19	June	13.9	82
55	8	O	Rockland L. & P.	11	.60	5.5	.77	D6	June	14.3	78
81	6	S	St. Joseph L. & P.	27	1.60	5.9	2.11	7	June	12.8	76
69	29	O	San Diego G. & E.	15	.80	5.3	1.37	20	Aug.	10.9	58
68	11	S	Scranton Electric	16	1.00	6.3	1.08	D9	Aug.	14.8	93
01	5	O	Sierra Pacific Pr.	25	1.60	6.4	2.11	5	Aug.	11.8	76
93	118	S	So. Calif. Edison	36	2.00	5.6	3.10	NC	Aug.	11.6	65
53	23	S	So. Carolina E. & G.	11	.60	5.5	.64	33	June	17.2	94
58	4	O	Southern Colo. Pr.	11	.70	6.4	.86	2	May	12.8	81
79	154	S	Southern Company	15	.80	5.3	1.15	22	Aug.	13.0	70
70	11	S	So. Indiana G. & E.	25	1.50	6.0	2.03	1	Aug.	12.3	74
78	2	O	Southwestern E. S.	15	.88	5.9	1.43	11	May	10.5	62
59	23	O	Southwestern P. S.	21	1.12	5.3	1.45**	10	July	14.5	77
35	13	C	Tampa Electric	42	2.40	5.7	3.21**	5	Aug.	13.1	75
4	82	S	Texas Utilities	40	1.88	4.7	2.95	28	Aug.	13.6	64
6	31	S	Toledo Edison	12	.70	5.8	.99	13	June	12.1	71
3	7	O	Tucson G. E. L. & P.	29	1.60	5.5	2.02	24	June	14.4	79
8	23	O	United Illuminating	42	2.40†	5.7	2.38	D16	Dec.	17.6	100
8	2	O	Upper Peninsula Pr.	16	1.20	7.5	1.37	1	June	11.7	88
4	24	S	Utah Power & Light	32	1.80	5.6	2.35	D3	July	13.6	77
7	69	S	Virginia E. & P.	26	1.40	5.4	1.80**	3	Aug.	14.5	78
6	18	S	Washington Water Pr.	27	1.30	4.8	1.59	28	July	17.0	81
1	100	S	West Penn Elec.	34	2.00	5.9	3.04	14	July	11.2	66
9	54	O	West Penn Power	41	2.00	4.9	2.28	7	June	18.0	81
3	8	O	Western Lt. & Tel.	26	1.60	6.2	2.25	12	June	11.6	71
	19	O	Western Mass. Cos.	33	2.00	6.1	2.10	D22	Dec.	15.7	95
	73	S	Wisconsin Elec. Power	25	1.30	5.2	1.73	—	June	14.5	75
	26	O	Wisconsin P. & L.	21	1.20	5.7	1.52	25	June	13.8	79
			Averages			5.7%				13.5	76%
			Canadian Companies††								
	134	C	Brazilian Trac. L. & P.	10	$1.00	10.0%	$2.47	5%	Dec.	4.0	40%
	15	C	Gatineau Power	20	1.20	6.0	1.30	D11	Dec.	15.4	92
	8	C	Quebec Power	18	1.00	5.6	1.17	D11	Dec.	15.4	86
	37	C	Shawinigan Water & Pr.	41	1.45†	3.5	1.84	D7	Dec.	22.3	79
	16	C	Winnipeg Electric	38	2.40	6.3	2.26	D7	Dec.	16.8	106

B—Boston Exchange. C—Curb exchange. O—Over-counter or out-of-town exchange. S—New York Stock Exchange. D—Decrease. NC—No comparable figures available. *If additional common shares have been recently offered, earnings are adjusted to give effect to the offering. Percentage change is in the balance available for common stock. †Estimated (rate irregular or includes extras). ††While these stocks are listed on the Curb, Canadian prices are used. (Curb prices are affected by exchange rates, etc.) #Stock dividend also paid. **Based on average number of shares. a—Includes regular stock dividend. b—The dividend pay-out ratio would be 74 per cent on the basis of budgeted earnings of $1.90 for the calendar year 1952.

What Others Think

Changing Concepts of Capital Exhaustion

BACK in 1947 The Rockefeller Foundation sponsored a study group of the American Institute of Accountants to consider the concepts of business income. This group consisted of some forty or fifty members, with an executive committee of six, composed equally of accountants and nonaccountants.

Last spring the report of the study group was made public in book form, *Changing Concepts of Business Income.* Public utility companies have been finding as much food for thought in the results—even though they are applicable to business enterprise in general.

The report goes back into the history of the cost principle in the pioneering book *Auditing,* published in London in 1892 by Lawrence Robert Dicksee, quoting various definitions of "profit" prior and since World War I. It reviews the growth of the "original cost doctrine" in public utility regulation. But in the chapter "Legal Considerations," the report comments upon the reluctance of businessmen to adopt accounting forms which would adjust costs to reflect depreciation in the purchasing power of the dollar. Mainly it is because they like to take full credit for the incomes shown in gross dollar volume of sales and reported net income. There is also the fear of another era of falling prices which would require business to write down the value of assets carried on the books.

But the report states:

> . . . The most pressing need right now for accounting reform concerns the effect of inflation on the determination of income. It should be possible to begin our reform by adjusting costs merely to reflect depreciation in the value of the dollar, and not appreciation, because today the long-term trend in the purchasing power of the dollar, at least as judged by the experience of the past eighteen years, has been merely in one direction—downward. Moreover, we might at first limit the application of such reform to the income statement, adjusting costs to reflect depreciation in the value of the dollar merely as and when those costs are matched against revenue in determining the income for a particular year. This would, of course, include the portion of costs representing exhaustion of assets attributable to such year, and not only tangible assets, the exhaustion of which is physical or due to obsolescence, but also intangible money assets, such as cash, accounts receivable, bonds, and so forth, the depreciation in value of which is occasioned directly by the depreciation in the value of the dollar.

IN a chapter on "Conclusions," the study group feels that, for the present, it may be well for business statements of income to be made on the currently accepted basis. But there is the suggestion that "corporations whose ownership is widely distributed should be encouraged to furnish information that will facilitate the determination of income measured in units of approximately equal purchasing power, and to provide such information wherever it is practicable to do so as part of the material upon which the independent accountant expresses his opinion."

In another conclusion, the study group finds that

> The annual financial statements of corporations are primarily reports of stewardship, and the methods of presentation should be determined with constant regard to that primary pur-

pose; but when corporations seek the advantage of marketability for their securities they incur an obligation of disclosure to investors generally.

It is highly desirable (as the tax statutes recognize) that income should be determined for income tax purposes and for general financial purposes as nearly as possible in the same way. This does not, of course, apply to provisions of the tax law which relieve a part of income from taxation as a matter of policy.

Out of the forty-four members participating in the study group, eight dissents were registered, while six special comments by way of concurrence or partial qualifications were noted.

The dissents include a statement by Charles W. Smith, FPC chief accountant, who insisted that utility books should be kept in the established monetary unit. He said any attempt to adjust the books to conform to the changing purchasing value of the monetary unit would result in a hodgepodge of practices not beneficial to business or the national economy. Mr. Smith said:

> As I understand the report, the majority of the committee would sanction the stating of depreciation on a value basis with values arrived at by the use of general price-index numbers. This method is less refined than the replacement-cost theory which has been advocated in other places, and which is discussed in the report. . . .

Mr. Smith goes on to give his objections to the replacement cost theory which chiefly center on the argument that existing plants simply would not be replaced, under present conditions, because of obsolescence, improved equipment and construction, etc.

WELL-KNOWN accountants George O. May and Oswald W. Knauth think the report did not go far enough. They stated:

> We agree with the opinion that modifications made in an effort to reconcile conflicting views have resulted in some loss of incisiveness in the conclusions. We think, for instance, that the group should have recommended that in the case of railways and regulated utilities, provisions for exhaustion of property computed on the basis of current price levels should be made mandatory, as a matter both of good accounting and of sound economic policy.
>
> However, an important result will have been achieved if the report leads to more general acceptance of the view that "business income" has two components which are separable and possess different significances, one reflecting the results of business activities measured in units of substantially equal purchasing power, and the other reflecting the results of changes in the purchasing power of the monetary unit on the final determinations of income.

The chairman of the study group was Percival F. Brundage. One of the members of the council was Arthur H. Dean of the New York bar, who is also the author of a very explanatory article on the allied subject of "Provision for Capital Exhaustion under Changing Price Levels" in the *Harvard Law Review*. (Vol. 65, No. 8, June, 1952.)

Mr. Dean raises the interesting question of Federal income tax in the light of deteriorated dollar values. How, he asks, can there be equitable taxation on income of the various members of society when no adjustment is made on past recorded costs for subsequent changes in dollar values? It might be argued that as long as the tax does not exceed 100 per cent of the taxpayer's income, this failure to make an adjustment is simply a disguised higher rate of income tax. But the end result is to tax the taxpayer according to the degree of contributed capital and according to the day he happened to make his investment. Reform in this respect, Dean thinks, might best come from Congress.

ADDRESSING himself specifically to public utility regulation, Dean asks the

"I'M NOT GOING TO CALL 'EM UNTIL I LOOK UP THEIR NUMBER—IN THE *LATEST* DIRECTORY!"

fundamental question: What is the purpose of such regulation? Is it not to substitute for competitive conditions which prevail in other fields? Yet we know that in other fields the industrial company has been able to take into account the change in value of the dollar in pricing its products. But actually it makes provisions for capital exhaustion out of its own revision by retaining and reinvesting a large proportion of its reported net income. Therefore the idea

that public utility rates should be regulated to levels which would normally prevail under competitive conditions supports the view that (for both operating income and rate of return) adjustment should be made in the value of dollar in determining the provisions for capital exhaustion. Mr. Dean explains this as follows:

> Nor does this seem unfair to the consumer. It is true that he will have to pay more for the gas and electricity he uses than if only the nominal dollar capital of the investor were to be maintained; but he likewise has to pay more for the products of nonregulated industries, reflecting the reduction in the value of the unit in which prices are quoted; and his own income in terms of those same units has generally more than doubled since 1939. Indeed, the long history of successive reductions in utility rates reflecting a passing on to consumers of the benefits of technological improvements may indicate that the needed rate increases would be less than most of the increases the consumer has experienced in the prices of other products. Moreover, if the physical properties of utility companies are not maintained intact, it may well be that future consumers will have to make up the deficiencies or suffer from impaired services.

To attract equity capital at yields competitive with industrial stocks, utility companies have often announced that they will pay out in dividends a substantial portion of their reported net earnings after interest and after taxes. With rates set so as to provide for capital exhaustion merely on the basis of unadjusted original costs, the economic capital invested in utility properties, according to Dean, is being dissipated invisibly by furnishing consumers with bargain-priced services. At the same time, the companies are unable to save enough out of reported net earnings to make up the difference. "A day of reckoning will eventually come," he says, "and then utility rates will have to be raised with a vengeance or government will have to provide the services."

Dean adds that every utility management is conscious of these problems and dangers. In many cases, however, it appears that management has been unwilling to make a real effort to convince the appropriate commissions of the realities of the situation and the acute need for relief.

It may be suggested that at least in some instances counsel and management have been overcautious. Regulatory and accounting principles, as well as the general course of the law, are, in the long view, always in a state of flux, even though at any given moment it may appear that conventionalism is firmly in the saddle.

Dean notes, with interest, that managements of many leading utilities in recent years have considered it their responsibility to present the commissions with these facts even though some commissions do not welcome any other kind of evidence except strict original cost. Dean mentioned in particular recent Bell system company telephone rate cases and the case of The Peoples Gas Light & Coke Company now before the Illinois commission. Whatever the result, he believes, the practice is encouraging as a sign that utility management is aware of its responsibilities.

In the final analysis, Dean asks a question: What is capital? Is it wealth in the form of economic assets or merely a bookkeeping figure? He states in his conclusion:

> Consider the case of the farmer who starts the year with a thousand bushels of seed corn. What is his capital, the corn or the number of bushels? If after he plants the seed but before he harvests his crop the size of the bushel is by government decree reduced from four pecks to two pecks, what provision must he make out of his year's produce to maintain his original capital intact? Yet today the taxing authorities and most of the utility commissions, apparently unconvinced that

our currency has permanently lost its purchasing power and that improved technical efficiency of new productive facilities will not bridge the gap between past original costs and current replacement costs, still insist that adequate provision is being made for capital exhaustion if a taxpayer or public utility company sets aside merely the same number of dollars as were originally expended for the property, irrespective of the fact that the value of the dollar as a unit of measure has changed.

MR. DEAN does not believe that there is any discernible evidence of price declines in the future except cyclical fluctuations. He warns that if our currency continues to deteriorate we may have to learn from hard experience the difference between form and substance in the matter of capital. And we may wonder that so obvious a point was so long delayed in acceptance.

CHANGING CONCEPTS OF BUSINESS INCOME. Report of Study Group on Business Income. The Macmillan Company. New York, New York. 1952. Price, $2. 160 pages.

Is Industry Selling Itself Out of Free Enterprise?

HAS American industry done such a good job in promoting and developing a market for its products that it has made its products indispensable and thus sown the seeds for a restriction and an ultimate destruction of its freedom of action?

Such was the intriguing question posed by Allen S. King, executive vice president of the Northern States Power Company, before the Minneapolis Sales Executives luncheon last September 4th. King described selling as the keystone of the American free enterprise system, pointing out that our productive processes, tremendous as they are, would stagnate without a consistent and expanding demand for the products of industry. "Selling," he said, "is the accelerating force of the system—selling in its broadest sense that of stimulating a continually expanding desire of the people to improve themselves and have more and more of the comforts and conveniences of life."

Noting that sales organizations have the greatest stake in the maintenance of a free system, King warned of dangers ahead unless steps are taken to counteract the possibility that "we may be selling ourselves out of free enterprise. We may become victims of our own outstanding success in stimulating and fulfilling the material desires of our people. We have made many things that once were gadgets, or at best luxuries, available to and the expected way of life of most of our people. To them these things have become necessities of life, and the people will not voluntarily do without them. They are even tempted to use the processes of government to assure themselves that these necessities shall always be available, and that no force, be it men or the functioning of economic laws, shall deprive them of these so-called necessities. The ownership of material 'things' has become even more important to many people than liberty itself."

ACCORDING to King, the implications of such a condition should give pause to all those who cherish a free economic system. The continual improvement of productive processes, he pointed out, has been creating bigger and bigger industrial units. "Bigness in itself creates antagonism from the mass of the people," he continued, "whether or not it is merited." The development of big industrial units has created greater opportunity for a possible "abuse of power by men who rise to high places; and some few will always yield to the temptation." Sensing this possible danger, the public becomes more and more disposed to permit encroachment by government into business life, "curtailing its freedom of action, and laying the groundwork for nationalization of certain essential indus-

tries; and ultimate socialization of our whole economic life with inevitable loss of personal freedom. Successful selling has resulted in bigness which, in turn, has given the advocates of socialization the opportunity to win over large portions of public opinion to their purposes. Such is the paradox facing American business, in King's view.

The electrical industry is an outstanding example of how the process works. A business in the typical American tradition, boasting a record of development that parallels or outstrips the economic progress of America in many fields, it stands out as an example of what free enterprise has accomplished and has earned for itself the right "not to be singled out for special treatment separate and distinct from other branches of our free enterprise system," the utility executive declared. First a toy, then a luxury, and now a necessity of life touching all phases of industry and home living—such is the 70-year story of the electric light. "Through that span of seventy years, we can visualize a procession of outstanding leaders of men who contributed their talents to the development—the inventors who have filled the patent files with evidences of man's genius, the engineers who have applied practical ingenuity to the development of the products of research, the men of management and finance whose aggressive initiative made possible the actual use of the products of man's brains on a scale not dreamed of, and the many others whose ambition and energy contributed to the building of the electrical industry as the servant of the poor, instead of merely a luxury of the rich or a tool of industry."

All this, King stressed, has been accomplished "without the shackling bonds of government dictation or control. . . . the electrical industry stands not only as an example of such free progress but also as a teammate in the parallel progress of many other phases of industrial life. And through it all, no material contribution to such progress has been made by any form of governmental activity."

As a matter of fact, the electrical industry has done such a good job of developing and selling, that its product has now become a necessity of life — "its progress has outstripped public understanding," King stated. As far back as 1920 the demand was heard that the industry be owned and operated by the government without profit and for the benefit of all the people in view of its acceptance as a necessity of life. "Such an attitude," King said, "presupposes stagnation, and the possibility of no further invention, development, or progress. I wonder what conditions would be today if we had heeded such reactionary thinking in 1920."

Since 1920 service has been expanded to six times the number of customers and usage of electricity in home and industry has gone up in greater proportions. Output of electricity has doubled within the last ten years with potentialities for the future which stagger the imagination. Why, then, do those who would halt such progress have a following? "Because," King stated, "through aggressive selling and promotion and through technical progress, we have made electricity an inexpensive necessity of modern life. Our own successes have created our greatest dangers."

The same process is working in other industrial fields. "More and more, big businesses are being asked to act in the 'social interest'; and more and more, government is interfering in their routine operation. The steel industry, for example, because of its bigness and its importance in our economy, and under governmental review of its prices and presidential coercion of wages, is drifting rapidly into a public utility status."

What can be done about the tendency of American industry to "sell itself out of American enterprise?" King has several suggestions:

1. The exponents of free enterprise should conduct their business practices with a view to stimulating rather than deterring the processes of free enterprise. "One of the essential elements of a free enterprise system," King said, "is

a free market and open competition. All vitality and initiative disappear under any form of cartel philosophy, price fixing, or the control of markets and competition by either government or group action. Cartel practices, the lack of a free market, and the efforts to eliminate competition by artificial means have plagued European business for years and are largely responsible for our American supremacy. We must not seek to freeze a market artificially by any means—for by such action we are contributing to the downfall of free enterprise."

2. An intensive public relations program should be designed to win the public to business methods, progress, and service. "If every business would only tell its own story, the cumulative impact upon the public mind would be tremendous," King argued.

3. A unity of action among all believers in the free enterprise system against government encroachment "in the other fellow's business." "Socialism is an insidious thing that spreads like a cancer through an economic system. Like a cancer, it must be stopped in its early stages or its growth gets out of hand and the patient will die."

4. Businessmen should preach the philosophy of opportunity rather than security. "Freedom and security are incompatible," King declared. "Freedom and opportunity are inseparable. History clearly demonstrates that when individuals attain security, comfort, and plenty, and when they no longer have the urge or desire to risk and climb, they wither and fall into decadence. Then the strong men rise up, assume control of the lives and welfare of the rest of the people, and all vestiges of freedom disappear, leaving the common man in slavery and oppression."

KING denounced what he called "a slot machine" philosophy of economics and politics. "The soul of American freedom," he said, "has been sinking to its destruction under the false philosophy of 'something for nothing.' We have been willing to sell our birthright of freedom for a mess of pottage. We seem to be unwilling to face a period of hardship with fortitude and hope in such a manner as to retain our economic and personal freedoms." He continued:

> Every phase of American life can stand indicted in this matter—individuals, businessmen, farmers, cities and towns, and state governments. When difficulties have arisen, all these groups have appealed to a centralized Federal government for help—there has been little thought of how much we could do for ourselves. As businessmen, individuals, special groups, and local governments, we have looked for security to a paternalistic government, and have neglected or forgotten to develop a continuing atmosphere of opportunity and risk. Such is the example we have been giving to our young people. Is it any wonder that they seem to seek security first, rather than opportunity? Those young people represent the future of our country. It is up to us to change our example to them, and set them straight regarding the essential elements of a free society.

IN concluding his remarks, King suggested that perhaps the same talent and energy demonstrated by "salesmen" in creating desires for products should now be directed toward creating in people a desire to retain the American free enterprise system. "We have demonstrated such amazing ability to sell material things; why don't we try in an organized way to 'sell' the most precious thing we possess? Our right to choose, our right to rise to any station in life, and our right to develop our God-given talents to the extent of our ability, are products of our free enterprise system functioning under a governmental tradition that encourages such freedom rather than oppresses it. The protection of such a birthright is worthy of our greatest thought and talents . . ."

—F. M.

The March of Events

In General

Natural Gas Output Tripled

MARKETED production of natural gas in the United States almost tripled between 1936 and 1950, according to a summary of natural gas statistics for this period published by the Bureau of Mines on October 1st.

This is the first summary of U. S. natural gas statistics published by the bureau since 1937, although such statistics are issued regularly on an annual basis. During this period, 1936-50, natural gas production increased from slightly over two trillion cubic feet to more than six trillion cubic feet. The bureau attributed "much of this rapid expansion to the increasing use of long-distance transmission lines."

"Texas was by far the greatest producer of natural gas in 1950," it said, "with a total marketed production of more than three trillion cubic feet. Next in line, producing nearly 832 billion cubic feet was Louisiana, followed by California and Oklahoma, with totals of more than 558 billion and 482 billion cubic feet, respectively.

Order Drawn on Power Cut

ELECTRIC utilities in the Pacific Northwest have been informed of emergency procedures for curtailing use of power this fall if there is a serious water shortage.

The Defense Electric Power Administration said curtailments of firm loads of power will be made so far as possible only after all interruptible industry loads have been cut.

Domestic users, it was said, probably would not be affected by any curtailment. Defense and other industries with contracts for firm power would be affected last in the industrial field.

Administrator Fairman said that a rough draft of a proposed limitation order had been sent the utilities. The proposed order is patterned generally after one issued last year—under which the authorized restrictions were never imposed.

Florida

Not Required to Pay Interest

FLORIDA private utility companies will not be required to pay interest on customers' deposits, according to a ruling by the state railroad and utilities commission. The ruling left the matter to the discretion of the companies, some of which do and some of which do not pay such interest.

Illinois

CTA Purchases Bus Rival

THE Chicago Transit Authority on October 1st took over the Chicago Motor Coach Company—a transfer resulting in a substantial increase in fares for 300,000 daily riders of the motor coaches. With the change-over, the coach fare of 15 cents was boosted automatically to the level of fares charged by the

CTA for its other surface line operations. These are 20 cents for the cash rider and 17 cents for users of tokens purchased in lots of five.

Mayor Kennelly seeking to delay action on the purchase assailed it on the ground that the proposed price of $16,500,000 for the properties was too high. He asked the CTA board to "review the transaction" and to issue a formal statement as to why the board believed the "benefits outweigh any apparent disadvantage in price." CTA Chairman Ralph Budd consulted with other board members and announced that the purchase would not be delayed and the mayor was being informed in detail of why board members felt that the price was justified.

Indiana

Attacks Phone Project Financing

THE Federal government's easy terms for financing a $6,800,000 rural telephone project in west-central Indiana were attacked as "fantastic" recently as the Hoosier Telephone Co-operative, Inc., attempted to win quick state approval of the plan.

Declaring that the newly organized co-operative lacks any money of its own to invest in the project, attorney for the intervening United Telephone Company, Inc., Warsaw, demanded that the state public service commission throw out the co-operative's petition for authority to purchase, rehabilitate, and expand 13 small telephone companies.

During testimony it was brought out that the co-operative plans to borrow $6,618,000 from the Rural Electrification Administration at 2 per cent interest payable over thirty-five years. But $286,000 in so-called equity capital upon which the REA loan is to be made, it was testified, also would have to be borrowed, most of it from various Rural Electrification Membership corporations in Indiana. This latter money would be repaid at 4 per cent interest.

Kentucky

Loan by Co-op to Another Questioned

"IT is very doubtful" that the Salt River Rural Electric Co-operative Corporation can legally lend money to the East Kentucky Rural Co-operative Corporation to manufacture electricity to be sold wholesale to co-operatives.

The assistant attorney general expressed this opinion recently in reply to a query from a Bardstown attorney. But he suggested a court test to get a definite ruling. He also said he had examined the charter of the Salt River Co-operative.

"In the absence of a provision" in that charter expressly authorizing it to lend money or engage in the banking business, he said he had reached the conclusion that "it is very doubtful" that this corporation can lend money to any individual, partnership, association, or corporation.

Massachusetts

Landowners Organize

THE Pipeline Landowners Protective Association was organized recently by a group of landowners from Andover, Coventry, and surrounding towns. The members own land through which natural gas pipelines are being built.

James H. Henry of Andover was elected president, Thomas G. Wells,

South Coventry, vice president; and Edgar W. Dynes, South Coventry, treasurer.

The association, formed to "protect the rights of landowners," hopes to extend its operations throughout the state.

Michigan

Rate Reduction Announced

THE Consumers Power Company early this month announced a rate reduction for electrical service in a 15-county area of northern Michigan.

B. D. Hilty, division manager, said the reduction would average about 6 per cent and would apply in a territory formerly serviced by the Michigan Public Service Company. Consumers took over the area in 1950.

The reduction added to two others granted in 1950 and 1951 will average about 18 per cent and result in a saving of $1.59 a month for the average customer, Hilty said.

Minnesota

Increased Water Rates Considered

AN increase in city water rates, designed to put the water department of Minneapolis on a pay-as-you-go basis for capital improvements and thereby eliminate bond interest payments averaging $176,250 a year, was under consideration by city authorities recently.

If the proposal materializes, it will mean a 20 per cent boost as of January 1, 1953, increasing costs to all users to 18 cents per 100 cubic feet or 24 cents per thousand gallons.

The present rate is 15 cents per 100 cubic feet or 20 cents per thousand gallons.

Out of the aggregate increase of $965,000 a year $175,000 annually would be assigned to a fund for purchase of new water meters in 1960.

Montana

Sees No Shortage of Power

THE Federal government has no more place in the power business than it would have in the grocery or medical business, President J. E. Corette of the Montana Power Company said recently.

That was his answer to President Truman's charge at Hungry Horse dam that Montana Power had opposed the huge project in northwestern Montana.

"But, wherever a Federal project exists, such as Hungry Horse," Corette went on, "we will co-operate in every way possible to get the power to the people at the lowest possible cost."

Corette said that nationally "there is no power shortage in areas where private utilities have had the responsibility of supplying the requirements.

"Power shortages that have existed have been primarily in areas where the Federal government has assumed the responsibility of supplying the power requirements, such as the Tennessee Valley Authority and the Bonneville area of Oregon and Washington.

"Surplus power which couldn't be used in Montana has consistently been sent to power-short Oregon and Washington. We now have and expect to continue to have a surplus of power."

New Jersey

Phone Rate Decision Appealed

THE New Jersey Bell Telephone Company early this month appealed to the appellate division of superior court for reversal of the ruling of the state public utilities commission that denied the company a rate increase totaling $9,800,000.

In contesting the ruling made September 20th, the company, which first asked the rate boost in April, 1950, said the denial had "jeopardized the company's ability to continue its service improvement program and to finance construction of new facilities for 25,000 persons still waiting for service and 70,000 others looking for better grades of service."

Pressing this point in its appeal, the company said that in expectation that the commission would grant the increase it had continued a $340,000,000 postwar construction program at "high gear" and had blueprinted $72,000,000 construction for the coming year.

The company said that since it first asked the increase its employees had won two substantial raises in pay which have "skyrocketed our operating expenses and reduced our earnings lower and lower."

North Carolina

Court Asked to Rule on Bus Regulation

THE state supreme court was recently asked to decide whether the state utilities commission can regulate busses carrying industrial workers to and from work. The commission contends state law does not give it such authority, while five bus companies claim that it does.

The companies appealed to the high state court from a ruling by Superior Court Judge Carr affirming a commission order which refused to approve a lease agreement between the Carolina Coach Company and Gabriel Bus Line, Inc., of Iredell county.

Carolina Coach had asked the commission to approve its lease to Gabriel of franchise rights to haul industrial workers from Landis to plants in Kannapolis.

The commission asserted it would be "unlawful and absurd" for it to approve a lease for rights "to provide a service which anyone and everyone had a right to perform."

The bus firm held that the commission had "in effect divested itself of its general power and duties" to regulate transportation of passengers by motor vehicle. It asked the courts to overturn the commission order.

Virginia

New Phone Rates Approved

THE state corporation commission recently approved new telephone rates proposed by the Chesapeake & Potomac Telephone Company of Virginia.

The new rates, which increase Richmond phone bills 25 cents a month for resident phones and 50 cents for business phones, became effective on bills sent out on October 10th.

Other increases, including intrastate long-distance calls and other supplementary services, also went into effect on that day.

The new rates are designed to give the company an added $2,950,000 in annual gross revenues.

Progress of Regulation

Fair Value Rate Base Theory Reaffirmed

A MARYLAND circuit court, although reversing an order authorizing a telephone rate increase, approved the principle of a fair value rate base. The court's objection to the order was based on procedure and return allowed rather than the standard used to determine value.

The commission's finding of present value could not be fairly reviewed since it was not apparent how it was determined. The court concluded that the order was based on "knowledge or information otherwise acquired" and must in law be regarded as arbitrary.

The Maryland legislature has enacted fair value into law, and a reasonable rate of return must be calculated upon that value. The court said that current value is a factor to be determined and that current cost (of reproduction) in determining that factor must be considered and given such weight as its relation to current value merits.

The commission was upheld in eliminating an allowance for cash working capital. The company's accrued tax funds supplied the need for working capital. The commission's conclusion in this respect was deemed to be supported by the evidence and reasonable even though it had been the consistent practice prior to this time to allow working capital.

The commission's allowance for rate of return was held to be too high because it gave no weight to tax economy. The company has no bonds outstanding and all of its stock is owned by American Telephone and Telegraph Company. Therefore, all of the company's net income is subject to income taxes, while dividends to the parent company on the stock are largely tax exempt. The commission found the company's capital structure should consist of 45 per cent debt and 55 per cent equity. Such a capital structure would result in lower taxes.

The court held that the commission, in determining a proper rate of return, should have considered the dollar value of the tax advantage to the parent company realized by reason of the existing capital structure of the operating company. *Chesapeake & Potomac Teleph. Co. v. Public Service Commission (Md Cir Ct 1952).*

Plant Straddling Municipal Boundary Line Receives Municipal Water Service

THE Wisconsin commission ordered a municipal water plant to furnish service to a corporation whose plant was situated partly within the municipality and partly within an abutting community. The municipality contended that the commission was without jurisdiction to require service to that part of the plant in the abutting community unless there was a contract between the parties.

The municipality had agreed to the corporation's request that connections to the plant be installed. It must have been apparent to the municipality, said the

commission, that the corporation contemplated an extensive development of the entire tract. Acceding to the corporation's request by laying such connections was evidence bearing on the question of whether the municipality was actually holding out or had undertaken to serve the abutting area.

The municipality, under easements and agreements, was serving several other companies in the abutting area but claimed that commission compulsion required such service. The commission pointed out that the municipality was required to serve the plant because the easements and agreements were voluntarily entered into and constituted a holding out to serve the area involved in the proceeding.

Because the municipality furnished connections to the plant in question and voluntarily accepted easements and agreements to serve other companies in the abutting area of the commission, it voluntarily assumed the obligation to serve the area and was obliged to serve that part of the plant in question that extended into the abutting area, notwithstanding the absence of any easement or agreement. *Square D Co. v. City of Milwaukee, 2-U-3737, August 14, 1952.*

Current Cost Adjustment to Rate Base Disallowed

THE Idaho commission awarded a rate increase to a telephone company which had experienced sharp increases in operating costs due to increased wages and taxes since the commission last considered its rates in 1951. The new rate would provide the company with a return of 7 per cent on its rate base.

After noting that the company had presented evidence as to current cost adjustment, "an adjustment to bring the investment in plant down to a period some time beyond the actual close of our test year, May 31, 1952," the commission said:

> This commission does not believe this to be a proper component in a rate base unless all other exhibits are adjusted to such a period so that the operating results can be estimated at the same date as the rate base is determined. If we were to use the weighted average rate base, then we would establish a rate base as of November, 1951, the mid-point of the test year used in testing the reasonableness of the proposed rates, and any return found to be fair now, due to the construction program and the increased plant investment that has been placed since November, could not be realized. Therefore, this commission will determine the rate base for this proceeding as the original cost net investment plus working capital as of May 31, 1952.

In supporting its request for additional revenue, the company presented evidence as to its extensive construction program and the difficulties which it was having in obtaining financing. The company's 47 per cent debt ratio made the issuance of bonds which would further increase this ratio appear to be an expensive proposition. The last bonds sold by the company were sold at 4 per cent only after lengthy negotiation.

The issuance of stock could be accomplished if the company's earnings were improved "so that it is earning at least two times the dividends on the presently outstanding shares, plus the dividends on the shares to be issued." If the present earnings ratio continued, dividends would be ultimately passed, and further financing would be impossible.

The company was directed to prepare a rate schedule which would provide a return of 7 per cent, which, under existing economic conditions, would enable the company to maintain its credit and financial stability. *Re Interstate Teleph. Co. (now General Teleph. Co. of the Northwest), Case No. U-1002-2 Order No. 2163, September 25, 1952.*

Meter Water Rates Substituted for Flat Rates

THE superior court of Pennsylvania affirmed a commission order upholding a new water tariff providing for meter service rates in lieu of flat rates. In recent years most of the company's customers have had their water supply piped indoors. Consequently, it has become possible to measure the quantity of water used by a given consumer and to charge accordingly. In former years the customers obtained their water from outdoor hydrants sometimes shared in common. This rendered metering impossible and necessitated flat rate service.

The court noted that meter rates are more equitable than flat rates. Since all customers do not use the same amount of water, a uniform flat rate unfairly distributes the cost. Metering, on the other hand, distributes the cost to the consumer in proportion to his use of the service and facilities of the company.

Furthermore, flat rate service is naturally conducive to careless and extravagant use of water. During dry periods of the year water at the dam drops to low levels. Increased consumption by the growing number of domestic users, when added to the heavy demands of industrial and municipal users, makes enlargement of storage capacity, at great cost, imperative. Metered service tends to reduce waste, inasmuch as wasteful use will be tempered by consumer self-interest.

The anticipated annual return under the new tariff amounted to 6.5 per cent of depreciated original cost, 3.8 per cent of depreciated reproduction cost, or 4.8 per cent of the average of those costs. It was pointed out that the company's figures, which the commission accepted, did not reflect booked depreciation. The commission had rejected booked depreciation as being entirely inconsistent with depreciation on the company's other fixed capital. The court said that accrued depreciation, for purposes of rate making, must of necessity be a judgment figure. It believed that the commission acted properly, since acceptance of book rates would result in accrued depreciation, in excess of 100 per cent, plainly inconsistent with actualities.

The court also held that it was not necessary, as contended, that reproduction cost be studied because the necessity of complete reproduction of the company's plant, as a result of physical deterioration, obsolescence, or major disaster was improbable.

The commission had refused to admit evidence of water rates prevailing in several neighboring communities. The court held that the commission acted properly since there was no evidence of similarity of conditions in the areas. Moreover, there was no evidence of improvident investment, or any other evidence in the record that would justify comparison of rates.

In any event, the court said, the evidence offered would be of slight probative weight, even if admissible, because a large discrepancy was not indicated and the extent of the field covered was very limited. *Orlosky v. Public Utility Commission et al. 89 A2d 903.*

Rehearing on Rate Order Not Required by Changes in Taxes, Wages, and Separations

THE New Jersey commission denied a telephone company's application for a rehearing of a proceeding in which a rate of return of 6.37 per cent was permitted. The company contended that the rehearing was required in order that it be afforded an opportunity to demonstrate the impact on its earnings of higher Federal income taxes, the changed procedures of separating interstate and intrastate telephone revenues and expenses (the so-called Charleston plan), and the changes in wage levels resulting from a new contract between the company and its employees.

Information provided by the company

on the effect which these changes would have on its net income indicated that a 5.66 per cent would be earned during 1952.

The commission pointed out that its rate orders operate prospectively and, consequently, are a matter of estimate. The fact that a return in a given period is more or less than the estimate does not indicate that the return is either excessive or insufficient. The commission continued by pointing out the consequences of not allowing some degree of flexibility:

> Otherwise minor and temporary deviations in the actual rate of return from the estimated rate of return would result in applications for increased rates or necessitate proceedings to lower rates following heel upon heel and rates would be in constant state of flux. Whether an actual increase over or decrease under the estimated return and rate of return is such as to warrant action by the board must rest in the board's sound judgment and discretion on all of the facts before it.

From all the facts presented the commission did not find that "the indicated return which may or may not prove to be the actual rate of return for the year 1952 is not within reasonable indicia of the fair rate of return" for the company. *Re New Jersey Bell Teleph. Co. Docket No. 5068, September 18, 1952.*

Space-heating Demand Charge Eliminated from Electric Rate

THE Idaho commission approved a power company's application for a rate increase subject to the company's elimination from its tariff of a proposed space-heating demand charge.

Before discussing the revenue needs of the company, the commission disposed of various motions made at the conclusion of the hearing. The first of these was by the State Federation of Labor, which requested that the new tariff be denied approval. The commission pointed out that the federation had offered no evidence but had merely noted its appearance. Since its motion raised no issue apart from the main question under discussion, the commission ruled that this motion had to be denied.

The second motion, made by counsel for twenty-two customers, requested the commission to deny a proposed increase in the last step of the energy charge in the rate from 1.5 to 1.75 cents per kilowatt hour. "This motion," the commission said, "should be denied as it would benefit only larger users of domestic service . . . and exempt them from the proportionate increase in charges which the smaller users would pay."

Another motion by the same twenty-two customers requested the elimination of the space-heating monthly demand charge. Since this matter was pending in another proceeding before the commission, the motion was granted pending decision in the other case. The commission made this comment:

> The use of electricity for modern house-heating installations in this area is relatively new. The commission is advised, however, that in other areas in the Pacific Northwest, where electric house heating is more prevalent because of generally milder climate, both publicly owned and private utilities supplying space-heating service, in lieu of a demand charge for the space-heating load alone, have modified the energy blocks in the rate or adopted a demand charge applicable to space-heating customers or to all users having demands exceeding a specified load.

One of the matters emphasized by the commission in its discussion of the need for higher rates was the increased cost of service. The commission observed that, owing to the deterioration in the purchasing power of the dollar, more dollars must be spent to provide the service for which a given item of cost is required.

These cost of living statistics were presented:

> . . . the cost of living index, based on publications of the U. S. Department of Labor, has risen from 100 in 1940 to 191.1 in June, 1952, and is still rising. The Handy-Whitman construction index, dealing with elements of cost entering into electric light and power construction in this (the Plateau) area shows an increase even higher, from an index of 209 in 1940 to 407 at the present time. Electric rates, which today have maintained their index levels of ten to twenty years ago, must eventually and inevitably reflect this trend.

The company did not request a specific determination of an official rate base or a finding of a specific return but, nevertheless, the commission approved the proposed rates (without the space-heating demand charge) since such rates would not provide a return of 6 per cent on the company's investment in operating facilities. *Re Idaho Power Co. Case Nos. U-1006-7, U-1006-8, Order No. 2159, September 17, 1952.*

Change in Commission Rules May Not Limit Prior Certificate Award

THE Montana commission did not consider that a motor carrier certificate issued in 1934 permitting the carrier to operate in a certain locality and "in the oil fields tributary thereto" was limited by a 1941 rule defining the meaning of the term "tributary."

The carrier had considered the 1934 certificate as conferring statewide authority and had acted accordingly. In 1938 the carrier leased his certificate. The board, in approving the lease, limited the lessee's operation to an area within 50 miles of the base territory. This limitation, the commission ruled, did not limit the carrier's authority but only limited the authority of the lessee.

A rule of the commission passed in 1941 defined the words "tributary thereto" as meaning a distance not over 50 miles from the point designated. In considering the rule and its application, the commission said:

> There does not appear to be anything which could be questioned as unreasonable in the rule and it corresponds in every respect to the practices of the board since its issuance. However, the issuance of such a rule could not affect any prior existing authority and in numerous cases, where the rule has conflicted with prior authority, hearings have been held, all parties interested have been notified, and the board has thereafter issued a proper certificate based on the evidence presented at such hearing. An authority once issued remains in force until canceled for cause (§ 8-112, R.C.M. 1947). This certificate has never been canceled and whatever authority was first issued to him remains in existence.

Re Alsup, Docket No. 3993, Order No. 2341, July 30, 1952.

Allocation Methods Prescribed for Natural Gas Production And Transmission Company

THE Federal Power Commission ordered a reduction in natural gas pipeline rates upon finding a return of 5¾ per cent to be fair, reasonable, and adequate to assure confidence in the financial soundness of the company. It concluded that such a return would enable the company to maintain its credit and to attract capital necessary for the proper discharge of its public duties. This return would provide a return for the common stock equity of 8.45 per cent, after servicing the

company's debt and preferred stock requirements and all income taxes.

The company's working capital allowance was reduced by an amount equal to 75 per cent of the Federal income tax. This adjustment was made in view of the advance collection from customers of sums to cover Federal income tax obligations.

In allocating costs of service between jurisdictional and nonjurisdictional sales, the commission classified all production costs as commodity costs, in view of the fact that they are intimately associated with the volumes of gas produced. The commission pointed out that all constant costs are not thereby translated into demand costs; that the determination of how much of the constant costs shall be apportioned between demand and commodity cannot be measured by the slide rule or any mathematical formula. Such a determination, it said, necessarily rests solely and entirely on judgment.

Return and income taxes, for example, were classified equally between demand and commodity. Distribution costs were also classified in this way. Demand costs were allocated among the transmission pipeline customers, although the company claimed that such costs should be allocated among all its customers, including the sales made at the well mouth and in the field. The commission said that since it has classified all production costs as commodity costs, transmission line costs should be allocated to transmission line sales. *Re Colorado Interstate Gas Co. Docket No. G-1115, Opinion No. 235, August 8, 1952.*

Co-operative Denies Service to Member Refusing Easement

THE supreme court of New Mexico upheld a rural electric co-operative association in its refusal to serve a member who denied it a right-of-way easement for a transmission line across his ranch.

The denial was held to have constituted a forfeiture of membership and an abrogation of a contract between the member and the association.

A person accepted as a member of a nonprofit mutual electric association on condition of his agreement to abide by all of its rules, regulations, and bylaws, cannot challenge the validity of the bylaws, according to the court. The statute providing for the organization of the co-operative, the articles of incorporation, bylaws, application for membership and membership certificate constitute a contract between the individual and the co-operative.

In so ruling, the court reversed a lower court decision enjoining the association from depriving the member of service and compelling its restoration. *King v. Farmers Electric Co-operative, 246 P2d 1041.*

Commission Refuses to Authorize Competitive Service by Interstate Motor Carrier

A PROTEST by the Capital Transit Company against an interstate motor carrier's petition for the designation of routes between the interstate carrier's existing terminal in the District of Columbia and a proposed on-street terminal at another point within the District was allowed by the District commission.

The applicant's contention was summarized by the commission in this way:

> . . . the position of the applicant was that it has unrestricted authority from the Interstate Commerce Commission to serve all points and places in the District of Columbia, subject to the designation of the particular streets and highways within the District of Columbia by the public utilities commission of the District of Columbia. Upon this basis, applicant did not believe the issue of convenience and necessity was here before this com-

mission, and that § 4 of the Merger Act (§ 44-201 D.C. Code 1940 Ed.) was not applicable to this proceeding. No testimony was offered by applicant to demonstrate the convenience or necessity for the proposed operation.

The applicant stated that no intra-District passengers would be carried. Capital Transit pointed out that the proposed route coincided with all but a small portion of the route of one of its busses and that its potential annual loss, if the new service were approved, was $68,500. Capital proposed an alternative provision that the commission limit the company's transportation of passengers between the District and certain points in the state of Maryland.

The commission first pointed out that it had no authority to impose any conditions on the interstate service of the carrier.

The main point in question was whether the proposed service was competitive with that of the protesting carrier. The commission found that it was and commented that "separate bus lines do not have to operate over identical routes to render competitive service."

Since the interstate carrier offered no evidence on the question of convenience and necessity, the commission indicated that it had no alternative but to withhold approval of a competitive service. *Re Oriole Motor Coach Lines, Inc. PUC No. 3331, Formal Case No. 416, September 4, 1952.*

Other Important Rulings

THE Wisconsin commission held, in a telephone rate proceeding, that since consideration is given to the level of the investment in property and plant for which the proceeds of newly issued securities would be used in part, it is reasonable that consideration be given to part of the additional securities in determining a reasonable rate of return. *Re North-West Teleph. Co. 2-U-3832, September 8, 1952.*

A Federal district court held a motor carrier guilty of violating the Interstate Commerce Act by transporting petroleum products without a required certificate where the carrier leased equipment to another carrier having the requisite certificate; where charges were billed by the lessor in the name of the lessee and collected, endorsed, and retained by the lessor; where employees of the lessor operated the equipment; and where wages, payroll deductions, drivers' logs, taxes, bookkeeping, and collections were controlled and paid by the lessor. *United States v. Canada, 105 F Supp 126.*

The Massachusetts Department of Public Utilities held that its jurisdiction over rates and charges fixed by a steamship authority is limited to disapproving the same and that it can neither suspend the taking effect of the rates so fixed nor prescribe other rates, as it is empowered to do with common carriers in general, nor regulate the service provided the steamship authority. *Re New Bedford, DPU 9591, July 30, 1952.*

The Colorado commission, in the course of fixing motor carrier rates, held that an individual owner should not deduct from his operation and maintenance expense a salary or personal drawing account. *Re Motor Truck Common Carriers' Asso. Case No. 1585, Decision No. 38951, July 28, 1952.*

The Colorado commission held that the actual authority of a private carrier permit can be determined only in the light of the language of the permit, the original purpose of the application, and the practical construction placed upon the language by those operating under it. *Overland Motor Express v. Seiwald, Case No. 5039, Decision No. 39142, July 29, 1952.*

The South Dakota commission denied a railroad express company a 6-cent increase per shipment, notwithstanding the fact that the company had been

awarded such an increase on its interstate traffic, where the record presented by the company in support of the increase was insufficient to warrant a 6-cent increase per shipment and where the company did not prove such a substantial loss as to entitle it to the relief sought. *Re Railway Express Agency, F-2354, August 1, 1952.*

A telephone company which would earn a return of approximately 2.28 per cent on its rate base if its present rate structure were continued, was authorized by the Wisconsin commission to increase its rates so that a 6.5 per cent return would be earned. *Re Milton Junction Teleph. Co. 2-U-3830, August 20, 1952.*

The Missouri commission, upon application for authority to discontinue certain passenger trains, held that an actual count of the number of individuals using the service offered is strongly persuasive as to the need of such service. *Re Chicago, G. W. R. Co. Case No. 12,208, May 6, 1952.*

The California commission held that it is not bound to follow the so-called benefits theory, in allocating the cost of separating grades, because the commission's authority to allocate such costs stems primarily from the Public Utilities Code and is an exercise of the police power. *Re Glendale, Decision No. 47420, Application No. 32385, Case No. 5327, June 30, 1952.*

The Pennsylvania Superior Court held that the test of whether the commission should grant an application for a motor carrier certificate is not whether existing service is satisfactory and adequate, but whether there is a public need for the service proposed to be rendered. *Follmer Trucking Co. et al. v. Public Utility Commission et al. 90 A2d 294.*

The Maine Supreme Judicial Court held that a driver-employee of a motor vehicle in interstate commerce was not guilty of operating within the state without a permit where the owner leased such truck to an interstate motor carrier company holding such permit and such company was considered the interstate carrier, because the lessor furnished driver and truck and carried the lessee's name, insurance was in both lessee's and lessor's name, and freight was moved on the lessee's bill of lading. *State v. Torrey, 90 A2d 456.*

The South Dakota Supreme Court held that parties objecting to a commission order authorizing the partial discontinuance or abandonment of motor carrier service under an amended motor carrier permit have the burden of proving that the commission acted unreasonably or arbitrarily, and the absence of record testimony supporting the commission action does not meet such burden. *Re Svoboda, 54 NW2d 325.*

The Florida Supreme Court held that a local freight tariff giving rates per hundredweight for the transportation of pulpwood between stations on the issuing railroad for various distances up to 50 miles was not applicable to intrastate transportation of pulpwood from stations on the issuing railroad more than 50 miles to the shipper's paper mill on connecting railroad for which both shipper and delivering railroad, as payee of freight charges, had accepted cubic footage rather than weight as the method of measurement. *Container Corp. of America v. Seaboard Air Line R. Co. et al. 59 S2d 737.*

A Federal district court held that the Ohio statute requiring interstate motor carriers, weighing 3 tons or more, to be equipped with metal protectors or flexible flaps on rear wheels to prevent such wheels from throwing dirt, water, or other material on windshields of following vehicles was a valid exercise of the state police power and did not conflict with or overlap any act of the United States Congress or any regulation of the Interstate Commerce Commission. *Tom's Exp. Inc. v. Division of State Highway Patrol (US Dist Ct Ohio 1952) 105 F Supp 916.*

Appendix

Important addresses on legal, economic, financial, and other problems, delivered before the Public Utility Law Section of the American Bar Association at San Francisco, September 15, 16, 1952.

Recent Developments in the Gas and Electric Fields Of Public Utility Law

By MILFORD SPRINGER*

Introduction

DURING the last year, the significant developments in the gas and electric fields of public utility law have been in the categories of jurisdiction of state and Federal regulatory commissions and of rate making by regulatory bodies.

1. Jurisdiction

A FAR-REACHING decision, which is considered of national importance, was rendered by the Federal Power Commission in the case of the Phillips Petroleum Company.[1] The Federal Power Commission majority decided that it had no jurisdiction over the facilities of production and gathering, or the field prices for natural gas sold by the Phillips Petroleum Company to various interstate natural gas pipeline companies. It was held that the sales of gas at the processing plants were incidents of production and gathering and that FPC rate regulation would interfere with state regulation of conservation.

The United States Supreme Court decided this year, in the Pennsylvania Water & Power Company Case,[2] that where there was a commingling of electric energy generated in Pennsylvania with energy generated in Maryland through an integrated power pool, that the Federal Power Commission had jurisdiction over all of the wholesale sales of the Pennsylvania Water & Power Company, even though the company contended that only 17 per cent of its total sales were made in interstate commerce.

THE ninth circuit court of appeals ruled that the Arizona Edison Company, distributing interstate electric energy at retail only to consumers in one state from facilities located in the same state, was a public utility subject to the Federal Power Commission's jurisdiction.[3] The company received energy from outside of the state and transmitted it over its lines for several miles to points where the energy was reduced in voltage and distributed to customers. This was an application to the electric industry of the rule of the United States Supreme Court in the East Ohio Gas Case,[4] in which it was held that a gas company operating entirely within the boundaries of a state and selling at retail only was still subject to Federal Power Commission jurisdiction because interstate gas was received into its high-pressure transmission lines inside the state of distribution and was transported many miles before the pressure was reduced for local distribution.

A significant development during the

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[1] (1951) 90 PUR NS 325.

[2] (1952) 94 PUR NS 1, 72 S Ct 843.

[3] (1952) 194 F2d 679.

[4] (1950) 338 US 464, 82 PUR NS 1.

last year was a proposed amendment to the Natural Gas Act to exempt companies like the East Ohio Gas Company from Federal regulation, because duplicate Federal and state regulation of certification of facilities, accounting, and depreciation practices served no useful purpose. The proposed amendment by Senator O'Conor to the Natural Gas Act (S 1084) was reported favorably by the Senate Committee on Interstate and Foreign Commerce in April, 1952, but insufficient time has been available to enact this legislation. Since this proposed amendment is approved by the Federal Power Commission and the National Association of Railroad and Utilities Commissioners, and is beneficial to the natural gas companies involved, it should become law within a reasonable period of time, even though it will require reintroduction of the proposed legislation in the next Congress. The Senate committee report stated: "The bill will result in the elimination of costly, wasteful, and duplicative regulation with ultimate savings to the consumers."

2. Utility Rate Making

THERE appears to be a trend by rate-making agencies to adopt a test period for fixing rates for the future, which is the latest twelve months' recorded experience adjusted for known changes. The Federal Power Commission and certain state commissions are proponents of this test year and refuse to adjust rates on the basis of forecasts of future operations, which they consider uncertain. Of course, the advocates of the forecast method have convincing arguments that the adjusted past experience method omits many costs which are predictable and which the utility actually experiences with the passage of time.

Prior to the Hope Natural Gas decision by the United States Supreme Court in 1944,[5] the emphasis in rate making had been on the rate base. There has been a gradual change of emphasis to the rate of return component in rate making, and during the last year this has become especially manifest. The Washington Gas Light Case by the District of Columbia commission this year, which allowed a 6¼ per cent rate of return on the depreciated original cost rate base, is a good example, containing extensive evidence by five witnesses on the subject of rate of return.[6]

THE natural gas industry of the nation was startled this year by the Federal Power Commission's decision, limiting the Northern Natural Gas Company to a 5½ per cent rate of return on a depreciated original cost rate base. Up to this year, the Federal Power Commission had fixed the rate of return by categories—for illustration, in the early 1940's the Federal Power Commission allowed a 6½ per cent rate of return for natural gas companies and a 6 per cent rate of return for electric companies, with the explanation that the investors considered the natural gas companies to involve greater risks. This year, for the first time, the Federal Power Commission is individualizing the rate of return by companies.

The Northern Natural Gas Company decision (Opinion No. 228) of June 11, 1952, used a test group of natural gas companies to determine the amount of earnings to be allowed on the common stock equity. Based on an average earnings-market price ratio of 8.1 per cent for the stocks of the test companies, the FPC granted an 8.75 per cent rate of earnings on the total common stock equity of Northern Natural. The composite cost of debt and equity capital was found to be 5.5 per cent, which was the measure of the allowed over-all rate of return. On July 29, 1952, the Federal Power Commission issued a rate decision concerning the Mississippi River Fuel Corporation (Opinion No. 234) and found that a 6 per cent rate of return on a depreciated original cost base was fair. It used the same test companies with an earnings-price ratio of 8.1 per cent, but granted Mississippi River Fuel a 9 per cent return on its total common stock

[5] 51 PUR NS 193.

[6] (1952) PUC No. 3517.

equity. Mississippi's own earnings-price ratio was 9.2 per cent. The commission noted that there was some risk in the Mississippi River Fuel Case, which could be considered unusual, because 60 per cent of its sales were industrial sales. The composite cost of debt and equity capital was determined to be 6.02 per cent. The historical cost to Northern Natural of debt capital was about one per cent lower than Mississippi River Fuel's cost.

CERTAIN financial experts say that the Federal Power Commission, in applying earnings-price ratios to a depreciated original cost rate base, is using an inconsistent measure of the compensation to which the common stock equity investment is entitled. The earnings-market price ratio is the measure of the reproduction cost of common stock capital, and results in combining inherently unlike quantities when applied to an original cost rate base. These experts assert that the consistent economic test is the rate of earnings experienced by comparable utilities on their total common stock equity investments, comprised of common stock capital paid in during the life of the enterprise, and earned surplus reinvested in the business.

Thus, if one ascertains the rate of earnings on the common stock equity investment in certain test companies and applies that ratio to an investment-type rate base, the allowed rate of return is consistent with actual earnings of the utility industry generally. That method is also in harmony with the declaration of the United States Supreme Court in the Hope Natural Gas Case that "the return to the *equity* owner should be commensurate with returns on *investments* in other enterprises having corresponding risks."[7] A recent study reveals, from the latest available information, that all of the natural gas companies reporting to the Federal Power Commission were earning 11.3 per cent return on their total common stock equity investments. And all straight natural gas companies in the United States reported by *Gas Facts* were averaging 12.6 per cent on common stock equity. This is a higher percentage than the earnings-price ratio measure, because the stocks involved are selling at prices considerably higher than their book value. The same financial experts state that the earnings-market price ratio, which is an inverse function of common stock prices, runs counter to actual earnings and economics, being low during prosperous periods and high in periods of depression. When applied to the original cost rate base, the result is to put the utility industry out of gear with the nonregulated industries with which it must compete for the investors' dollars.

THE magnitude of a slight difference in the allowed rate of return for utilities is apparent when one realizes that a small change in the percentage rate of return is equivalent to many times that variation in the rate base. The difference between a 6 per cent and 8 per cent return is equal to a 33⅓ per cent variation in the rate base. If a $300,000,000 rate base is involved that percentage difference in return is equivalent to $100,000,000 of rate base. The depreciated original cost of the electric industry and the gas industry in the United States for the last year was roughly estimated to be $24,731,000,000. If the rate of return for these combined industries were increased by only one-half of one per cent on that assumed rate base, it would amount to $123,600,000 a year, and would do much to preserve the financial vitality of the gas and electric industries. Assuming there are 75,000,000 persons who have the benefit of gas and electric service in the United States, such maintenance of financial strength for these utilities would cost less than $2 a year more per user. This would be a bargain to the consumers for the assurance of continuity of quality service by the gas and electric industries.

INFLATION has hit the growing utilities hardest, because it costs much more

[7] (1944) 320 US 591, 603, 51 PUR NS 193.

today to add a new customer than prewar, and replacements are many times costlier than the original facilities. Millions are being spent for new plant which produces no new revenues. The result is an automatic shrinkage in the realized rate of return, and makes some rate increases obsolete before they become effective. Among the commissions which have made allowances for this recognized attrition in return are Utah, Colorado, and California. For example, in California the commission recognized the declining trend in the rate of return experienced by the gas department of the Pacific Gas and Electric Company.[8] Gas rates were increased last year and the commission tested the rates on a 6.29 per cent return basis as applied to a depreciated original cost rate base, because it was expected to decline in twelve months to 6 per cent, which the commission found as the fair rate of return. Here is intelligent, tangible compensation for the effects of inflation on investment in facilities. The shrinkage factor was about three-tenths of one per cent and you can see that if a utility had a $350,000,000 rate base it would produce the equivalent of more than a million dollars additional net revenue for return.

IN the Wisconsin Electric Power Case,[9] the commission rejected a utility's contention that the common stockholder should have the integrity of his investment maintained by compensation for the decline in the purchasing power of the dollar during this period of structuralized inflation.

There are various ways for commissions to allow utilities to earn enough to meet their financial requirements and to attract new capital economically. The original cost rate base can be increased by trending, the rate of return can be fluctuated in gear with the economic cycle, or other adjustments made, and farsighted commissions should undertake this task with the skillful assistance of you lawyers who sponsor evidence to enable the regulators to exercise informed judgment.

[8] (1951) 51 Cal PUC 130.

[9] (1952) 93 PUR NS 97.

Discussion of Developments in Transportation Law Subsequent to July 1, 1951

By GEORGE L. BULAND*

THIS discussion of developments in transportation law will be largely confined to developments in railroad transportation law. This is not because I am not aware of the importance of other forms of transportation. In fact, those of us concerned with railroad transportation are, at times, painfully aware of the expansion of other transportation agencies. It is due to the limitations of time and my own limitations.

Railroad Rates and Charges

THE inflationary trend continued in the past year requiring railroad rates to be increased in line with increased labor, material, and tax costs. The important decision was that of the Interstate Commerce Commission, April 14, 1952, Ex Parte No. 175, Increased Freight Rates, 1951. The commission in its decision authorized a general increase of 15 per cent (inclusive of interim increases previously authorized), as sought by the carriers, upon their freight charges subject to certain limitations and holddowns, the authority to maintain the increase to expire February 28, 1954. Petitions for rehearing, particularly by certain western state commissions, directed against allowance of the full increase for western carriers, were denied September 4, 1952.

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This decision is important because it marked a recognition by the Interstate Commerce Commission that railroads, in times of business activity, should be permitted to charge rates which, in addition to meeting their costs and providing for a minimum continuance of railroad transportation, will provide net earnings adequate to attract capital for investment in the industry and to provide a return somewhat comparable to returns obtainable by investors in other businesses.

THE Interstate Commerce Commission, in general rate increase cases, deals only with interstate rates. Although the commission makes its calculations as to earnings to be derived by carriers upon the assumption that the increased rates will be made applicable intrastate, it is necessary for carriers to obtain authority from state commissions to increase intrastate rates. This procedure encounters obstacles in the reluctance of state commissions to grant increases and, in any event, long delays are involved. The Interstate Commerce Commission has authority, under § 13 of the Interstate Commerce Act, to order increased rates into effect if it finds intrastate rates discriminatory against persons or locations engaged in interstate commerce or discriminatory against interstate commerce.

In King *v.* United States (U.S. District Court, Northern District of Florida), 101 F Supp 941, decided June 29, 1951, the court sustained decision of the Interstate Commerce Commission finding that the Florida Railroad and Public Utilities Commission had discriminated against interstate commerce in not making fully effective in intrastate commerce increases authorized by an earlier general rate increase case (Ex Parte No. 166, Increased Freight Rates, 1947) and directing that such increases be allowed.

A comparable holding sustaining the Interstate Commerce Commission in removing a discrimination imposed by the Illinois Commerce Commission in requiring continuance of commutation rates so low as to burden and discriminate against interstate commerce was rendered by the U.S. District Court, Northern District of Illinois, October 31, 1951, State of Illinois *v.* United States, 101 F Supp 36; affirmed February 4, 1952, 342 US 930.

AGAIN the commission was sustained in ordering removal of a discrimination against interstate commerce by the New York Public Service Commission in refusing authority to raise New Haven commutation fares to a level comparable to interstate fares by the U.S. District Court, Northern District of New York, State of New York *v.* United States, 98 F Supp 855. This decision was affirmed per curiam by the U. S. Supreme Court, November 26, 1951, 342 US 882, although with dissent by Mr. Justice Douglas, who did not think that the commission's findings were adequate and in compliance with the views expressed in North Carolina *v.* United States, 325 US 507. On the other hand, a U. S. District Court in Montana, by decision in August, 1952, enjoined enforcement of an order of the Interstate Commerce Commission requiring that intrastate rates in Montana be raised in order to correspond to a general rate increase authorized by the Interstate Commerce Commission on the ground that the commission had not made adequate findings, that it had not found the amount of revenue required for intrastate traffic in Montana, and had not found prejudice against interstate commerce; that mere discrepancy between intrastate rates and interstate rates was not sufficient to sustain a § 13 order. This decision stems, of course, from the 1945 decision of the U. S. Supreme Court, North Carolina *v.* United States, 325 US 507, an opinion by Mr. Justice Black with four dissents. The majority decision in this case had imposed more exacting standards for findings sufficient to sustain a § 13 order than had previously been thought necessary by the commission.

WHATEVER the area of dispute as to the rate of return which carriers should be allowed to earn, there can be no doubt that in an inflationary cycle

there must be upward adjustments in transportation charges and there would seem to be little argument as to the desirability of such adjustments being fairly closely related to the increased costs given cause therefor. This subject of regulatory lag will be discussed at a later session of this section.

Transportation service rendered for the U. S. government has become increasingly important and rates for government traffic present special problems. The types of commodities shipped, the quantities shipped, the occasional emergency character of shipments, and the vastness of government operations and personnel to some extent differentiate government shipments from commercial shipments. The government should, however, pay its fair share of transportation costs since a concept of free enterprise will not be furthered by discriminations against private individuals in favor of government. There still remains pending the so-called Government Reparations Cases, some 17 in number, which were consolidated for hearing before the Interstate Commerce Commission, involving an endeavor by the government to recover as much as $2 billion from the railroads. Briefs are in and the cases are awaiting an examiner's report. In addition to issues as to the reasonableness of the rates, other questions presented are the application of the 2-year statute of limitations to the government, the binding effect of agreements on quoted rates under § 22 of the Interstate Commerce Act, and the treatment of excess profits taxes paid by railroads upon charges now alleged to be excessive.

A LARGE number of government shipments moved during World War II and now move under special rates, not published or available to the public, which are authorized to be granted the government by § 22 of the Interstate Commerce Act. It is believed that reparation procedure is not appropriate in the case of such agreed rates. The vastness of the amounts involved does not permit retroactive adjustment without seriously impairing the railroads' finances, especially where no statute of limitations is recognized. It would seem preferable to have the government held to special rates accorded it when agreed upon by responsible government officers. A bill to that effect was introduced in the last Congress, S 2355, and was favorably reported by the Senate Committee on Interstate and Foreign Commerce and recommended in principle by the Interstate Commerce Commission.

Railroads are exempted in respect of their charges from price stabilization. Section 402(e)(v) of the Defense Production Act of 1950 exempted "rates charged by any common carrier or other public utility." A question arose as to whether this exemption applied to charges made by the carrier in the course of its common carrier business which were not pursuant to published tariffs. It was held in United States *v.* Pennsylvania R. Co. (U.S. District Court, Eastern District of Pennsylvania, June 19, 1952) that the exemption applied to charges for washroom and toilet facilities. This exemption was written into the act by amendment of June 30, 1952. There are other customary nontariff charges which are not covered by the specific exemption, and question may remain in regard to them as, for instance, charges for baggage storage, etc.

A RATHER puzzling question was determined in Armour & Co. *v.* Louisiana Southern R. Co. (U.S. Circuit Court of Appeals, Fifth Circuit, August 4, 1951), 190 F2d 925, certiorari denied 342 US 913. The Interstate Commerce Commission is given power in case of emergency to make orders affecting car service, including increasing demurrage charges, by § 1(15), Interstate Commerce Act. Such an order was made by the commission but the railroad company did not publish immediately the increased demurrage charges in its tariffs. The issue was whether the increased demurrage charges applied by reason of the commission's service order prior to publishing of the charges. It was held that the commission's order was self-executing and the increased charges applicable.

Railroad Transportation Service

UNDER § 1(18) of the Interstate Commerce Act, the Interstate Commerce Commission is given authority over the abandonment of railroad lines, or the operation thereof, of a carrier engaged in interstate commerce. However, this authority does not extend to reductions in, or discontinuance of, passenger service on railroad lines. Such authorities as may have been vested by the states in their regulatory bodies continue in effect.

The great bulk of intercity passenger travel is by private automobile. Passenger busses take a share and laterally there has been a great expansion in air carriage of passengers. Railroad passenger service is waning, although it is still the largest individual factor in common carrier passenger service as measured by passenger miles. Short passenger railroad runs are used very little by the public and railroads have sought to divest themselves of this type of operation or reduce service thereon.

State regulatory bodies, however, have been reluctant to allow discontinuance or lessening of such operations and, in some instances, have contended that improved equipment and facilities will allow railroads to compete and, in any event, the losses suffered must be endured. There have been many recent decisions sustaining the right of rail carriers to discontinue unprofitable passenger service where there is no real public need for continuation of such service.

SINCE July 1, 1951, there have been additional cases. In Chicago, M., St. P. & P. R. Co. *v.* Michigan Public Service Commission, 332 Mich 291, 50 NW2d 884, decided January 8, 1952, the Michigan Supreme Court sustained the decree of the circuit court setting aside order of the Michigan commission requiring a railroad to continue and improve certain interstate and intrastate railroad service on the ground that the order was unreasonable, arbitrary, and confiscatory. In Illinois C. R. Co. *v.* Illinois Commerce Commission (1951) 410 Ill 77, 101 NE 2d 588, the Illinois Supreme Court affirmed a circuit court decree setting aside an order of the Illinois commission refusing authority to discontinue unprofitable passenger service which was lightly patronized. There is a case pending in the California Supreme Court involving an order of the California Public Utilities Commission refusing authority for discontinuance of mid-day trains between Oakland Pier and Sacramento and requiring purchase and use of a new type of self-propelled cars.

Power of Commission to Compel Establishment of Through Routes And Joint Rates

PARAGRAPHS (3) and (4) of § 15 are controversial portions of the Interstate Commerce Act.

Paragraph (3) gives the commission power to compel carriers to join in through routes and joint rates.

Paragraph (4) contains limitations, one concerning short hauling a participating carrier but with qualifications upon this limitation, and also other limitations.

Two decisions of the U. S. Supreme Court, decided June 2, 1952, dealt with these paragraphs, Thompson *v.* United States, 343 US 549, and United States *v.* Great Northern R. Co. 343 US 562.

Without attempting to state these cases, or all that was involved in them, we can draw off this generalization.

The limitations of Paragraph (4) upon the power of the commission under Paragraph (3) of § (15), apply only to through routes, as distinguished from joint rates for existing through routes; a new through route is not involved where traffic has been moving over such route but pursuant to a combination of local rates and not to through rates; a new through route is involved where there had previously been a physical connection but where no traffic in substantial volume had moved.

Liability of Carriers in Carriage of Goods

UNDER § 20(11) of the Interstate Commerce Act, embodying the

Carmack and Cummins amendments, a carrier and shipper may contract that claims must be filed within nine months. The Uniform Bill of Lading provides that claims in writing must be filed within the nine months' period. The general assumption that this provision was valid, and must be enforced by carriers to prevent discrimination, was seriously disturbed by the decision of the court of appeals of the seventh circuit in Hopper Paper Co. *v.* Baltimore & O. R. Co., 178 F2d 179, certiorari denied, 339 US 943, decided December 12, 1949. In that case a claim in writing was not presented within nine months but the court held that, nevertheless, the shipper could recover the value of a carload shipment of paper destroyed in a wreck on the lines of the defendant carrier, where the carrier knew about the loss and, in fact, had notified all interested parties thereof.

Decisions within the past year, reported and unreported, have pretty well demonstrated that the Hopper Case was not a landmark in the law but merely a judicial aberration. Reported decisions declining to follow this case or confining it to its particular facts are Insurance Co. of North America *v.* Newtowne Manufacturing Co. court of appeals, first circuit, 187 F2d 675, decided March 15, 1951; Wood & Selick *v.* Wabash R. Co. (supreme court, app. term), 104 NYS 2d 488, decided March 29, 1951; Delphi Frosted Foods Corp. *v.* Illinois C. R. Co., court of appeals, sixth circuit, 188 F2d 343, decided April 10, 1951; Public Service Electric & Gas Co. *v.* Reading Co. NJ, 85 Atl2d 548, decided December 24, 1951; Northern Pacific R. Co. *v.* Mackie, court of appeals, ninth circuit, 195 F2d 641, decided April 2, 1952.

In Reider *v.* Thompson, 339 US 113, decided March 13, 1950, the U. S. Supreme Court, reversing the court of appeals for the fifth circuit, held that the Carmack Amendment (§ 20(11), Interstate Commerce Act), making the initial carrier liable to the holder of the bill of lading for loss and damage to goods, applied in the case of a shipment from a nonadjacent foreign country to the United States so that the first carrier in the United States was liable for any damage to the goods during the domestic portion of the transportation, at least where the first domestic carrier issued a new bill of lading. This decision upset the view generally entertained that the Carmack Amendment did not apply to shipments from nonadjacent foreign countries into the United States. Hauck *v.* Gulf C. & S.F. Railway (Tex Civ App), 246 SW2d 913, decided February 8, 1952, held that it was still true that the Carmack Amendment did not apply to a shipment from a nonadjacent foreign country, the Philippine Islands, to the United States, and that the Reider Case is to be explained on the ground that in that case a new bill of lading was issued by the first domestic rail carrier entirely independent of the through bill of lading. It is probable that the distinction was well taken and the Reider Case is to be so confined.

A perplexing question presented to the managements of railroad and motor carriers with some frequency is what measures should be taken to serve industry plants at which there are strikes and picket lines. In Pacific Gamble Robinson Co. *v.* Minneapolis & St. L. R. Co. United States District Court, District of Minnesota, decided March 17, 1952, 105 F Supp 794, 21 Labor Cases, Par 66,857, the court found that the carrier in question had failed to furnish cars upon request to the plaintiff because of disinclination to order its employees to cross a picket line set up by striking plaintiff's employees, notwithstanding the absence of any threats of violence by the strikers and although the railroad did not seek police protection nor injunctive relief.

Under these circumstances, it was held the carrier had not exercised due diligence to perform its common carrier function and was liable for damages to the plaintiff; that these could be awarded by the district court and did not relate to technical or administrative matters exclusively within the jurisdiction of the

Interstate Commerce Commission. The court expressly recognized that the duty of a carrier to furnish railroad cars and switching service was not absolute and stated it was not necessary to determine how far a carrier would have to go to perform its duty. There are several cases pending against western carriers involving the question of liability to serve strike-bound plants under other circumstances.

Railroad Security Issues

SEVERAL developments affecting railroad security issues took place during the past year.

In May, 1944, the Interstate Commerce Commission, Ex Parte No. 158, in *Re* Competitive Bidding in Sale of Securities, 257 ICC 129, required railroad bonds as well as equipment securities to be sold upon competitive bidding but authorized carriers to request exemption from the requirement if, under the circumstances, competitive bidding should not be desirable. The commission has granted a number of such specific exemptions but it has now indicated a tightening up upon exemptions. In Finance Docket No. 17748, Atlantic Coast Line Railroad Company Competitive Bidding Exemption, decided June 18, 1952, it authorized exemption from competitive bidding for the sale of $20,000,000 of the carrier's general mortgage bonds, series C, but stated it would be its position thereafter to deny requests for exemption if the carrier, before obtaining the required exemption, entered into any discussions or any negotiations with respect to the terms of sale with any prospective purchaser. In Finance Docket No. 17845, Southern Railway Company et al. Proposed Competitive Bidding Exemption, decided August 20, 1952, it refused permission of the Southern Railway Company and its subsidiaries to sell $46,000,000 of bonds without competitive bidding.

It likewise refused permission to the Illinois Central to sell $62,000,000 of bonds to refund present bond issues without competitive bidding in Finance Docket No. 17848, Illinois Central Railroad Company Competitive Bidding Exemption, decided August 18, 1952.

THE recordation of equipment securities, *i.e.*, equipment trust leases and agreements, mortgages, conditional sales, etc., relating to railroad rolling stock of carriers engaged in interstate commerce was simplified by act of Congress, approved July 16, 1952, 66 Stat 724, adding § 20c of the Interstate Commerce Act to provide for filing of such instruments with the Interstate Commerce Commission in lieu of complying with the recording or filing requirements of the various states. This not only simplifies such recording but provides better theoretical protection for investors. Formerly, to protect investors of such securities, it was necessary theoretically to record the security instrument in every state of the Union though recordation was, in practice, confined to states in which a substantial accumulation of equipment could be anticipated.

Legislation

AT the last Congress, three measures were enacted directly affecting transportation. It was made clear that the exemption from regulation for motor carriers carrying livestock, fish, or agricultural commodities, not including manufactured products thereof, should extend to horticultural products, Public Law 472, approved July 9, 1952. To regulated carriers, this amendment of § 203(b)(6) of the Interstate Commerce Act seemed to be a step in the wrong direction. The amount of securities which may be issued by motor carriers without approval of the Interstate Commerce Commission was increased from $500,000 to $1,000,000, Public Law 492, approved July 10, 1952. Filing of equipment trust agreements and other documents with the Interstate Commerce Commission was provided by Public Law 556, approved July 16, 1952.

Conclusion

IN this narration of decisions and enactments for the past year, I have

touched little upon the subjects of greatest concern in the transportation industry.

Transportation is now performed by airlines, by motor carriers and busses, by inland and coastal water carriers, and by railroads. Each form of transportation has its place and contributes to the national economy.

The problem is to adjust regulation, public aid, taxation, and other factors, so that these forms of transportation may compete fairly among themselves and each can make a maximum contribution to the public welfare. This problem will be dealt with in the years ahead through legislation and judicial decision.

A part of the problem is to redistribute the promotional and regulatory activities of the Federal government which have grown up more or less like Topsy into a logical pattern administered by an effective and co-ordinated agency or, possibly, agencies.

In meeting these problems there are encouraging factors. Technological advances and industrial organizations have increased the efficiency of all forms of transportation and are continuing to do so. The problems, therefore, concern a vigorous industry well worth all the attention that can be given to it. Furthermore, the attitude of the American people, as we read it, favors the working out of the problems through private enterprise and rejects government control as a solution.

Developments in the Past Year—Telephone Rate Regulation

By FLETCHER ROCKWOOD*

Your vice chairman asked me to discuss developments in the past year of the law of communications. I accepted with the understanding that I would limit myself to the field of telephone rate regulation.

My firm does some work for an associated company of the Bell system, but I do not speak here as a Bell system attorney. I will refrain from discussion of what the Bell system believes the development should have been in the past or what it should be in the future.

In a large measure telephone regulation in the past year has been a continuation of the process started early in the postwar period. Since then telephone companies have appeared before regulatory authorities in all states, and in most states on several occasions, seeking increases in intrastate telephone rates. In this respect the postwar history of the telephone companies is similar to that of other utilities.

I will not discuss problems common to all utilities, such as the need for revenue to enable the utilities to attract capital for expansion of plant, the measure of a fair return to accomplish that purpose, the character of the evidence relevant to prove that fact, and the general effects of inflation on the answers to these questions.

Neither will I speak on problems peculiar to telephone rate cases which are of little interest to lawyers who have no dealings directly with telephone rates.

There have, however, been two significant developments in the past year which, though not peculiar to the telephone industry, have manifested themselves principally in telephone rate regulation. The first of these is in the matter of separation procedures. The second has to do with the treatment by regulatory authorities of what has been characterized as attrition. I will speak briefly on these two subjects.

Separation

"Separation" in telephone parlance is the process by which plant, revenues, and expenses of a utility engaged in furnishing interstate and intrastate service are allocated between these serv-

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ices to permit determination of the return which has been or will be received from each.

Substantially all telephone plant is used in common in interstate and intrastate service. The instrument on the subscriber's desk is used at one moment for an intrastate call, local or toll, and at the next for an interstate toll call. Separation is essential to measure the results of operation of the two categories of service, interstate and intrastate, since the first is subject to Federal regulation by the Federal Communications Commission and the second to state regulation by the several state commissions.

Separation is not a new problem. In 1913 in the Minnesota Rate Cases[1] the Supreme Court recognized the necessity for separation in a case involving intrastate railroad rates. In 1930, in Smith *v.* Illinois Bell Teleph. Co.[2] the separation problem was discussed by the Supreme Court in a telephone rate case. In both cases the court required that separations be based on relative use of property in the different services.

EVEN before that second decision efforts had been made to devise sound methods to show separately the results from interstate and intrastate telephone business, and those efforts have continued to the present day.

It is essential that the methods applied by the Federal regulatory authority having jurisdiction over interstate rates and by state authorities which regulate intrastate rates be uniform. If not, some property and some expenses will be ignored by both authorities and the result will be that the over-all return from the total business will be less than a fair return, or, possibly, some property and some expenses will be assigned to both intrastate and interstate with the tendency to produce a return from total business higher than either regulatory authority might consider adequate.

Shortly after the passage of the Communications Act of 1934, Bell system counsel asked the Federal Communications Commission to exercise the power which it was believed was granted to it by the act[3] to prescribe separation procedures which would be binding upon all regulatory authorities, Federal and state.[4] This request was repeated in May, 1941, in a petition by the Bell system to the FCC.

FOLLOWING this in June, 1941, a joint staff committee of the Federal Communications Commission and the National Association of Railroad and Utilities Commissioners (which I will refer to as the FCC and NARUC) undertook a study of the subject. After a year of research, working in co-operation with engineers of the Bell system, the committee completed the preparation of what, with some later amendments, has come to be known as the "Separations Manual." This was presented to the FCC at hearing in 1942 in its Docket No. 6328, initiated for investigation of separation procedures. No decision has been rendered in that docket.

Since 1942, Bell system companies have applied the principles developed by the joint staff committee, together with amendments made from time to time by the committee, in all separation studies presented to state commissions in intrastate rate cases.

The Bell system has gone further. It has adopted the Separations Manual methods as a part of the uniform Bell system contracts between the American Telephone and Telegraph Company and the associated companies for divisions of revenue from interstate service handled under joint through rates.

MANY of you are aware of the fact that in practically all states the level of intrastate toll rates has been and is higher than the level of the uniform Bell system interstate toll rate schedule. Thus a call from A to B, a distance of 100 miles entirely within one state, may cost more

[1] 230 US 352.
[2] 282 US 133, PUR1931A 1.
[3] Sections 4(i), 219(b), 213(f), and 221(c), Communications Act of 1934.
[4] FCC Docket No. 2551, hearing November 16, 1934, Tr. page 80.

than a call from A to C 110 miles across a state boundary, an interstate call. This may appear to be anomalous, but the explanation is simple. One obvious reason is that interstate calls are to a large extent what our railroad friends would call long-haul traffic, and intrastate calls are predominantly short hauls. Much of the investment in telephone plant is in the very elaborate terminal equipment in central offices. With two terminals involved on each call the long-haul traffic is relatively cheaper per mile than is the short-haul business. The interstate rate schedule which reflects the economies of the predominance of the long-haul business is thus lower than intrastate schedules which do not have these advantages.

So long as interstate rates, regulated by the FCC, are based on costs they will be lower to produce a given rate of return than will be intrastate rates regulated by the individual states likewise based on costs. This consequence is probably inevitable under separate regulation of the two types of service so long as rates are based on costs. No reasonable method of separation based on relative use, as required by the Supreme Court, can entirely eliminate that end result.

THE state commissions have been disturbed by the disparity of the interstate and intrastate toll rate levels. It is a thing which some uninformed telephone users find hard to understand and there has been constant criticism of state commissions for failure to remove it. The telephone user may fail to appreciate that as long as intrastate rates, exchange and toll, must together produce a fair return on the plant devoted to intrastate service the consequence of a reduction of intrastate toll rates might well be an increase in exchange rates even more unpalatable to telephone users than the toll rate disparity.

At the annual meeting of the NARUC at Charleston, South Carolina, in October, 1951, a revision of the Separations Manual was presented. Under those procedures substantially more plant and related expenses would be attributed to interstate, and correspondingly less to intrastate, than under former methods.

This so-called Charleston Plan was approved on an "interim basis" by a resolution of the NARUC and was also approved on an "interim basis" by the FCC.[5]

In intrastate rate cases since the Charleston meeting Bell system com-

[5] See recitals in FCC order of November 21, 1951, Docket 9889, relating to interstate rates; and secretary's certification of December 10, 1951, stating adoption of changes on October 9, 1951.

[6] CHARLESTON PLAN APPLIED WITHOUT RESERVATION

State	*Company*	*Docket*	*Date of Order*
Alabama	Southern Bell	12920	1/25/52
Colorado	Mountain States	11245	5/ 6/52
Florida	Southern Bell	3151-TP	1/29/52
Georgia	Southern Bell	195-U	11/ 1/51
Indiana	Indiana Bell	22948	3/24/52
Kentucky	Southern Bell	2103	12/31/51
Maryland	Ches. & Pot.	5176	3/11/52
Massachusetts	New England Tel. & Tel.	DPU-9789	7/18/52
Michigan	Michigan Bell	T-252-52.13	6/ 5/52
Minnesota	Northwestern Bell	M-3090	2/ 1/52
Missouri	Southwestern Bell	12100	1/15/52
Montana	Mountain States	3940	1/24/52
Nebraska	Northwestern Bell	18757	1/24/52
New Mexico	Mountain States	328	4/21/52
New York	New York Tel.	15235	3/10/52
North Carolina	Southern Bell	E-55, Sub. 20	4/28/52
North Dakota	Northwestern Bell	4772	2/15/52
South Dakota	Northwestern Bell	F-2319	1/26/52
Washington	Pacific Tel. & Tel.	U-8350	11/ 1/51

panies have applied the Charleston Plan and have accepted the consequences thereof that the revenue required to produce a given rate of return on intrastate business is less than that which an application of procedures followed prior to the plan would have produced. Some nineteen state commissions have applied the plan without reservation in rate case orders.[6] (See page 592.) Some seven commissions have applied the plan with a reservation of right to re-examine the matter in subsequent cases.[7] Three commissions have declined to apply the plan.[8] The orders in these three cases are being reviewed in the state courts.

No one can say that separations principles as applied to the telephone industry are fixed for all time to come. Accounting classifications first prescribed by the Interstate Commerce Commission in 1913, are still subject to evolutionary processes. The joint staff committee itself, without departure from the principle that separations must be made on the basis of relative use, has adopted several changes since 1942. There may be others.

The NARUC resolution, approving the plan, recited that " . . . it is essential that a single uniform method of separations be used by state and Federal jurisdictions . . . " In the past year there has been real progress towards the goal of uniformity of method for application by all regulatory authorities.

The telephone company is not the only utility which has a separation problem. Any utility operating in more than one state has it in some degree. We may hope that these advances in the telephone field will be helpful in the broad field of public utility regulation.

Attrition

"ATTRITION" as I use that term with respect to telephone earnings is the phenomenon of the wearing away or reduction in the rate of return under a constant schedule of telephone rates by economic forces which have operated in the postwar period and apparently will continue to operate in the future.

A given schedule of telephone rates may be sufficient to produce a fair rate of return under conditions which exist at the moment the rates become effective, but the economic forces in operation at that moment will result in a decline of the rate of return in the future.

In some degree this problem of attrition is accentuated by the inevitable lags in regulatory processes. This matter of regulatory lag is the subject for discussion at another meeting of the section and I will not attempt to tie it into my remarks.

Attrition of the rate of return in the telephone business is the consequence of several factors. I will enumerate a few:

(1) There has been a great increase in the cost per unit of telephone plant installed since the war above the cost per unit of telephone plant installed prior to the war, and the upward trend of the cost of plant has not stopped. I will illustrate

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[7] CHARLESTON PLAN APPLIED BUT WITH RESERVATION THAT IT WAS SUBJECT TO FURTHER STUDY

State	*Company*	*Docket*	*Date of Order*
Connecticut	New York Tel.	8509	7/22/52
Illinois	Illinois Bell	39126	12/10/51
Kansas	Southwestern Bell	35,000-U	1/23/52
Oregon	Pacific Tel. & Tel.	UF-1614	1/11/52
South Carolina	Southern Bell	7235	8/13/52
Tennessee	Southern Bell	U-3177	1/31/52
Wisconsin	Wisconsin Tel.	2-U-3573	1/30/52

[8] CHARLESTON PLAN REJECTED

State	*Company*	*Docket*	*Date of Order*
Maine	New England Tel. & Tel.	FG-1370	5/19/52
Nevada	Bell of Nevada	117	12/14/51
West Virginia	Ches. & Pot.	3718	5/16/52

the effect of this factor. Suppose a company has in plant two telephones, with related equipment, installed at a prewar cost of $200 per telephone or a total investment of $400. From this plant it derives net revenue of $14 per telephone, a total of $28, or a rate of return of 7 per cent. Tomorrow it installs another telephone at a postwar cost of $400 and from this it likewise derives net revenue of $14. From the three installations at a cost of $800 it derives $42 of net revenue which is equal to a rate of return of 5.25 per cent. Thus the mere addition of the high-cost plant with no increase in rates drops the return from 7 per cent to 5.25 per cent.

(2) Telephone plant installed in the prewar period at the relatively low-cost levels, is constantly being replaced as it exhausts its life with equivalent plant installed at the higher postwar cost levels. Thus, even without any enlargement of plant, the return declines under a constant schedule of rates. The effect is substantially the same as in the illustration I gave of the expanding plant.

(3) The level of operating expenses, including wages, material prices, ad valorem taxes, income taxes, and depreciation on the high-cost postwar plant, has been rising constantly. This factor obviously results in a reduction in rate of return produced by a given schedule of rates. The telephone industry is peculiarly vulnerable to the effects of this factor, especially as it includes wage costs. Some 65 per cent of telephone operating expenses consist of wage payments. I am told that wages make up only some 25 per cent of the operating expenses of electric utilities.

THESE three factors are present in all utility business. I describe two additional factors which may be peculiar to the telephone business:

(4) The revenue per telephone under a given schedule of rates is trending downward. This is not the consequence of any reduction in use. It is the result of change in the distribution of telephones between different types of users. Thus, while business installations which produce the largest revenue per telephone have increased, residence installations have increased more rapidly. Furthermore, because of the inability of the companies to build plant fast enough to fill orders for grades of service requested there has been a relatively larger growth in 4-party and 2-party service than in higher-priced 1-party service.

(5) The changes in the living habits of the people in this country have resulted in increased investment per telephone in the postwar period. Since the war suburban population has increased relatively more rapidly than in the established urban centers of population. More outside plant is required to serve a customer under these conditions. Coupled with the increased investment to serve the suburban subscriber are the corresponding increases in expenses, including particularly maintenance and depreciation. With the same revenue from the distant suburban subscriber as is received from the subscriber close to the central office, the return declines as the proportion of suburban subscribers increases.

THESE factors which produce attrition were not present in the prewar years in anywhere near the degree in which they have appeared since the war.

Prior to the war the orthodox measure of the needs of a utility for revenue was its experience in the immediate past. If its revenue in the preceding year or in the immediately preceding twelve months produced a return above or below that determined to be fair, the regulatory authority directed a reduction or authorized an increase in an amount such that the revenue under the new rates, had they been in effect in the past test period, would have produced a fair return.

That did not produce patently inequitable results so long as the price levels for new plant and for operating expenses were not subject to sharp changes in one direction or the other.

The general practice of regulatory authorities in the postwar telephone rate cases has been to apply that orthodox prewar method. But it has not worked under the influence of factors causing at-

trition; and its application by the commissions has been, I believe, a principal reason for the frequent return of the companies to the commissions for further increases.

I COULD obtain for you patterns of returns in several states to illustrate this. Charted they resemble a ripsaw. The return declines. The commission, using the past test period method, authorizes an increase in rates to bring the return immediately up to the rate determined to be fair. The trend line at the time of the rate order is vertically up. Attrition immediately operates to cause a decline and the trend slopes down. The company applies for a further increase and a second order is made authorizing an increase and the process is repeated. The result has been that the averages of the rates of return in the postwar period have generally been below the levels found by the commissions to be fair.

The prewar orthodox method has frequently been modified in commission application by giving weight to known factors in existence at the time of hearing. Thus if a hearing is held on October 1st and the fact is that on the previous June 1st a wage increase became effective, the commission will usually accept a showing of results in the past test period modified to reflect a full year's effect of the wage increases. That does not, however, adequately compensate for attrition. It still gives weight to facts only as they have actually occurred in the past in measuring the company's needs for the future. It still ignores the facts which will cause attrition, even though it is demonstrable that they will occur, merely because they have not yet occurred.

IN the past year there has been an indication, at least, of a departure by regulatory authorities from the old prewar procedures and a real application by them of the rule of the Supreme Court that the fixing of rates for the future must take into account the factors which will operate in the future to affect the utility's net earnings.[9]

Unfortunately, I believe, the effects of attrition have not been recognized by all commissions in recent cases. In orders in the past year several commissions still adhere to the prewar orthodox methods.

The commissions which have given weight to attrition have done so either by an increase in the rate base or by the allowance of a higher rate of return or by a combination of both.

Under orthodox procedures the rate base was the average of the plant in service during the past test period. The commissions in four states, Colorado, Maryland, Minnesota, and Montana, in recognition of attrition, have used the end of period plant rather than the average.[10] The Kansas commission used average plant in a future year 1952 in an order of January 23, 1952.[11] The Missouri commission used plant as estimated for the end of a future period 1952 in an order of January 15, 1952.[12] The Georgia commission in an order dated November 1, 1951,[13] and the New Mexico commission in an order dated April 21, 1952,[14] used average plant in the past year but increased by allowances variously determined to recognize attrition. Thus

[9] Missouri ex rel. Southwestern Bell Teleph. Co. (1923) 262 US 281, 287, PUR1923C 13; St. Louis & O'Fallon R. Co. *v.* United States (1929) 279 US 461, 485, PUR1929C 161; Dayton Power & Light Co. *v.* Commission (1934) 292 US 290, 310, 3 PUR NS 279.

[10] See below.

[11] *Re* Southwestern Bell Teleph. Co. Docket No. 35000-U.

[12] *Re* Southwestern Bell Teleph. Co. Case No. 12,100, 92 PUR NS 481.

[13] *Re* Southern Bell Teleph. & Teleg. Co. Docket No. 195-U, 91 PUR NS 97.

[14] *Re* Mountain States Teleph. & Teleg. Co. Docket No. 328.

[10]

State	*Company*	*Docket*	*Date of Order*
Colorado	Mountain States	11245	5/ 6/52
Maryland	Ches. & Pot.	5176	3/11/52
Minnesota	Northwestern Bell	M-3090	2/ 1/52
Montana	Mountain States	3940	1/24/52

eight states have recognized attrition by increases in the rate base.

SIX states, Colorado, Florida, Kansas, Minnesota, Missouri, and South Carolina have allowed a rate of return higher than would have been allowed were not attrition a factor.[15]

You will note that Colorado, Kansas, Minnesota, and Missouri appear in both lists and gave effect to attrition in both the rate base and the rate of return. The circuit court of Marion county, Indiana, in an opinion supporting an injunction issued on January 30, 1952, of an order of the Indiana commission,[16] likewise held that the effects of attrition should be recognized both by an increase in the rate base and an increase in the rate of return.

Recognition of the effects of attrition is not a matter of concern only to the utility being regulated. It is, I believe, essential in the public interest. If allowances are not made for attrition the utility, in an inflationary era, can never for any extended period in the future earn the rate of return which the regulatory authority finds to be reasonable. The inevitable result in the long run of such a policy will be that the utility will be unable to attract the capital necessary properly to meet its obligations to the public to render adequate service. The public will be the ultimate sufferer.

It remains to be seen whether the allowances made for attrition by the commissions I have enumerated have been adequate. But, in any event, we may hope that the treatment by these states of the effects of attrition has started a trend and will be followed by others.

[15] See below.

[16] Indiana Bell Teleph. Co. *v.* Public Service Commission, Cause No. 68502.

[15]

State	*Company*	*Docket*	*Date of Order*
Colorado	Mountain States	11245	5/ 6/52
Florida	Southern Bell	3151-TP	1/29/52
Kansas	Southwestern Bell	35000-U	1/23/52
Minnesota	Northwestern Bell	M-3090	2/ 1/52
Missouri	Southwestern Bell	12100	1/15/52
South Carolina	Southern Bell	7235	8/13/52

State Regulation of Air Carriers

By EVERETT C. McKEAGE*

WITHOUT meaning to minimize any other development concerning the regulation of air carriers, I shall confine my remarks substantially to the recent development where it was held that state authority is competent to regulate the intrastate rates and charges of air carriers, even though the carrier be, also, engaged in interstate commerce.

Preliminarily, I desire to state that I am a passionate believer in the Jeffersonian philosophy of states' rights. You may call me an unreconstructed rebel and I wouldn't contradict you. I reject the ancient federalist doctrine that "A good judge expands his jurisdiction." It is not in harmony with the ethos of our political philosophy, as some bureaucratic-minded regulators would have you believe, to assert that interference by government in the private affairs of the people is the rule and not the exception. Interference by government in private affairs of industry and business should be undertaken only when the public welfare so demands.

However, while I deplore expansion of governmental authority in the regulatory field by the process of usurpation or impermissible interpretation of the scope of authority actually granted, on the other hand, I equally believe that, wherever the law does create regulatory jurisdiction, the regulator is in duty bound to exercise that jurisdiction unless the same be of the permissive or discretionary type.

*Chief counsel, California Public Utilities Commission.

APPENDIX

THE inherent nature of the subject which I will discuss involves the difficult problem of conflict of Federal and state jurisdictions. I regret to say that such conflict is on the increase because of the fact that both jurisdictions are increasing the scope of their regulatory activities.

It is most unfortunate that you have among Federal officials men who would either subjugate the states to complete Federal dominance or ignore them; while, at the same time, you find state officials who look upon the Federal authority as though it were a foreign government. These two extremes are not helping the problem. But I do assert that the evidence of history demonstrates that, in this running conflict, there is more fault on the part of the Federal authority than on the part of the states. Naturally enough, this would be so because the Federal authority, being dominant, has the greater opportunity to abuse its power.

I think it can be said that history clearly demonstrates that the conflict between state and Federal authority may be contained but never completely resolved. It is a continuing conflict and will always be so from the very nature of our Federal system. I assume that the best way to live with this conflict is to follow the philosophy of Jefferson and Madison; that is, that state and Federal authorities should seek a wise accommodation between their activities to the end that each shall function in its proper sphere and each be ready to accord a tolerance wherever emergencies or circumstances should call for the exercise of such tolerance.

Some of the larger air carriers contend that the Federal authority has completely occupied the field of air transportation, both interstate and *intrastate,* and that any state authority thereover has been entirely superseded. Notwithstanding the fact that, on several occasions, proposed legislation seeking such complete occupation of the field of air transportation by the Federal authority has been defeated in the Congress, these air carriers have persisted in such contention.

The philosophy underlying this totalitarian contention is that air transportation is *sui generis;* that it is radically different than other fields of regulated industry and requires Federal uniformity of regulation; and that the national defense is so dependent upon air transportation that to subject such transportation to the regulation of 48 little Civil Aeronautics boards would be contrary to and dangerous to vital national interests.

An extreme contention has been made that, because of the very nature of air transportation, the several states are incompetent, from a legal standpoint, to regulate any phase of such transportation, the Federal Constitution, *ex proprio vigore,* having completely occupied the field. These extremists follow this contention by the corollary one that, if, perchance, they be wrong in such contention, the fact is that the national importance of air transportation is such that the states should be prohibited from exercising any regulatory authority thereover or laying profane hands thereon, even though it be purely intrastate transportation, by complete Federal occupation of the field. And, believe it or not, these extremists assert that the Federal authority has completely occupied the field.

THE large flaw in both their logic and legal argument is that the Supreme Court of the United States disagrees with them.

You, as lawyers, are familiar with the ancient and elementary rule that a state has authority to regulate and even burden interstate commerce of a local nature provided the state does not discriminate against such commerce.[1]

Also, you are familiar with the equally

[1] Panhandle Eastern Pipe Line Co. *v.* Michigan Pub. Service Commission (1951) 341 US 329, 333, 89 PUR NS 1, 95 L ed 993, 998; South Carolina State Highway Dept. *v.* Barnwell Bros. 303 US 177, 189, 82 L ed 734, 741; Cities Service Gas Co. *v.* Peerless Oil & Gas Co. (1950) 340 US 179, 186, 87 PUR NS 41, 95 L ed 190, 202; Railway Express Agency *v.* New York, 336 US 106, 111, 93 L ed 533, 539.

ancient and fundamental rule that, where interstate commerce of a local nature is concerned, Federal occupation of that field will be declared only where the act of Congress is irreconcilable with the exercise of state authority in the same field.[2] The Supreme Court of the United States has held in a relatively recent case that, where Federal regulation does not exist in the field of interstate commerce of a local nature, it will be presumed that state regulation is necessary.[3]

The Federal authority may partially occupy the field of interstate commerce of a local nature, leaving the remainder of that field to state regulation. And, even in matters that would appear not purely of a local nature, the states have been left free to regulate, such as in the case of insurance and certain of the interstate operations of interstate utilities.

ONE of the strongest presumptions known to the law is that Federal authority has not superseded state authority in the intrastate field because the superseding of state authority by the Federal government in such field strikes at that delicate balance between Federal and state jurisdictions upon which our Federal form of government is based. *Such supplanting of state authority is a counterrevolutionary form of warfare upon the genius and wisdom that created an indissoluble union of indestructible states.* Hence, the superseding of state authority will be declared only where there is no possible doubt as to the clear intent of the Congress to so supersede state authority. Furthermore, it must clearly appear that the Federal invasion of state authority is necessary in order to protect the national interest. Nothing must be left to inference or presumption.[4] Any doubt that may exist as to the superseding of state jurisdiction must be resolved in favor of state authority.[5]

The contention made by some of the large air carriers that there is something inherently unlawful or impracticable involved in the regulation by a state of the intrastate operations of these carriers, who are also engaged in interstate operations, falls before the historical fact that the intrastate operations of the large telephone, telegraph, railroad, motor carrier, and gas and electric utilities have been regulated by the states for years with the unqualified approval of the Supreme Court of the United States. So far as difficulty of separation of intrastate and interstate properties and operating results is concerned, there could not possibly be any greater problem with air carriers than with railroads and motor carriers. Why operations in the air are different than operations on the ground is not readily perceived. Separation is more difficult with telephone and telegraph utilities such as the giant Bell system and Western Union.

THE philosophy underlying the contention that the provisions of the Federal Constitution and the state constitutions, at the date of their adoption, could not have had in mind or comprehended air transportation and, for such reason, the conventional rules applicable to common carriers by land and water, for some unexplained and abstruse reason, do not apply to such transportation has been rejected by the Supreme Court of the United States.

More than fifty years ago, that court, in the celebrated Debs Case,[6] which grew out of the Pullman strike, repudiated such constitutional heresy in the following language:

> Constitutional provisions do not change, but their operation extends to new matters as the modes of business

[2] Kelly *v.* Washington, 302 US 1, 9-15, 82 L ed 3, 10-13.

[3] Panhandle Eastern Pipe Line Co. *v.* Michigan Public Service Commission (1951) 341 US 329, 333, 89 PUR NS 1, 95 L ed 993, 998.

[4] Palmer *v.* Massachusetts, 308 US 79, 82-85, 84 L ed 93, 96-99; Yonkers *v.* U.S. 320 US 685, 690, 691, 88 L ed 400, 403-405; North Carolina *v.* U.S., 325 US 507, 511, 89 L ed 1760, 1765; Alabama Public Service Commission *v.* Southern R. 341 US 341, 346, 95 L ed 1002, 1007.

[5] Arkansas R.R. Commission *v.* Chicago, Rock Island & Pac. R.R. Co. 274 US 597, 603, 71 L ed 1224, 1228.

[6] *Re* Eugene Debs et al. 158 US 564, 591, 39 L ed 1092, 1105.

and the habits of life of the people vary with each succeeding generation. The law of the common carrier is the same today as when transportation on land was by coach and wagon, and on water by canal boat and sailing vessel, yet in its actual operation it touches and regulates transportation by modes then unknown, the railroad train and the steamship. Just so it is with the grant to the national government of power over interstate commerce. The Constitution has not changed. The power is the same. But it operates today upon modes of interstate commerce unknown to the fathers, and it will operate with equal force upon any new modes of such commerce which the future may develop.

No logical or legal reason exists why the same rule should not apply to the interpretation of a state constitution.

IN line with this reasoning, the supreme court of Nebraska, construing the Constitution of that state, rejected this subjective philosophy in a case involving air transportation, stating the constitutional rule as follows:

> . . . A Constitution is intended to meet and be applied to any conditions and circumstances as they arise in the course of the progress of the community. The terms and provisions of constitutions are constantly expanded and enlarged by construction to meet the advancing affairs of men. While the powers granted thereby do not change, they do apply in different periods to all things to which they are in their nature applicable. Pensacola Teleg. Co. *v.* Western Union Teleg. Co. 96 US 1, 24 L ed 708; 11 Am. Jur. Constitutional Law, s. 51, p. 660; 9 Am. Jur. Carriers, s. 4, p. 430. These principles have been held to be applicable to transportation by air. "Transportation, as its derivation denotes, is a carrying across, and, whether the carrying be by rail, by water, or by air, the purpose in view and the thing done are identical in result." Curtiss-Wright Flying Service *v.* Glose, 3 Cir. 66 F2d 710, 712, certiorari denied, 290 US 696, 54 S Ct 132, 78 L ed 599. See, also, Hotchkiss, *The Law of Aviation* (2d ed.), s. 45, p. 62; Fixel, *The Law of Aviation* (3d ed.), ss. 372, 375, pp. 361, 364; McCusker *v.* Curtiss Wright Flying Service, Inc. 269 Ill App 502. . . . Common carriers by air are indistinguishable from other common carriers with respect to the policy of the law. Any person or organization engaged in transportation by air for hire is a common carrier.[7]

THE contention made by these air carriers is based, to an extent, upon the totalitarian premise that a centralized authority is more efficient and convenient than the asserted inefficiency of forty-eight separate authorities. This type of argument is as old as tyranny itself, and the principle underlying it was rejected by the Founding Fathers in the creation of our Federal system. It was the great Jefferson who pointed out that a heavy government is easy for the governors but subversive of the rights of the governed. Equally in point is Abraham Lincoln's observation that "democratic government is better than good government." That very "inefficiency" which permits of a lively interest in local authority and autonomy at the expense of totalitarian "efficiency" *is a merit* in itself and a price which the people of this nation can well and willingly afford to pay. This posture of the subject has been fittingly exemplified by the Supreme Court in the case of Davis Warehouse Co. *v.* Bowles, 321 US 144, 153-155, 88 L ed 635, 642, 643.

Substantially sixteen to eighteen of the states, in one way or another, undertake to regulate intrastate air transportation. Some of the regulatory authority is very meager. To say the very least, the states have not risen to their full opportunity to regulate the intrastate field of air transportation.

As a matter of fact, the laggard atti-

[7] State ex rel. State Railway Commission *v.* Ramsey et al. 37 NW2d 502, 506.

tude on the part of the several states in exercising their authority has been cited to the Congress as one of the justifications for the superseding of state authority by the Federal government in the field of air transportation. The majority report of the House Committee on Interstate and Foreign Commerce in support of HR 3420, 78th Congress, pointed out the backwardness of the states in undertaking the regulation of air transportation as one of the reasons for the adoption of this bill which sought to supersede all state authority over any and all air transportation. The following excerpt from the minority report relating to said bill pointed out the attempted assault upon the rights of the states which the bill contemplated:

> The signers of these minority views do not agree with HR 3420, as reported by the committee because (1) it destroys states' rights . . .
>
> (b) The committee bill (by specific provisions hereinafter set forth) *takes away* [emphasis added] all rights of the states:
>
> (1) *To regulate intrastate commerce by air,* including certificates, permits, rates, and all other matters normally subject to the state regulation of intrastate operations of public utilities. (Page 41 of report.)

Attempts were made in the 78th, 79th, 80th, and 81st Congress to completely or partially supersede state authority in the field of air transportation but such efforts failed.

It is my opinion that, in certain circumstances, Federal authority has superseded state authority in the field of safety as applied to air commerce. The Federal act would appear to indicate such to be the fact.

The recent litigation which specifically determined that the states have authority to regulate the intrastate rates of air carriers, even though such carriers be, also, engaged in interstate commerce, arose here in California.

From the inception of air carrier operations in California, the public utilities commission of that state had required air carriers to file with it their intrastate rates and charges, albeit most of these carriers filed such rates under protest. This applied particularly to those carriers which were, also, engaged in interstate commerce. During the year 1944, one of the larger air carriers refused to file with the commission its intrastate rates and charges but, after the commission issued an order of investigation against this carrier calculated to enforce compliance with the direction of the commission, the carrier filed its rates under protest.

Later on, a number of purely intrastate air carriers entered the field in California, the bulk of the operations being generally between the San Francisco area and the Los Angeles area. Certain of these carriers entered the so-called coach class field of air transportation and some of the large interstate carriers followed suit. All carriers eventually filed with the commission their rates and charges for this coach class service. This particular service between San Francisco and Los Angeles then became the subject of a general investigation by the commission as to the reasonableness of the rates charged therefor.

After hearing, the commission rendered a decision on March 14, 1950, finding such rates to be reasonable.[8]

In the early part of 1951 two of the large air carriers, operating both in the interstate and intrastate fields, and two of the purely intrastate carriers sought authority from the commission to increase their coach rates between San Francisco territory and Los Angeles territory.

The two carriers, operating both in the interstate field and the intrastate field, asserted that the Civil Aeronautics Board had authorized them to increase their interstate coach rates. These requests were rejected by the commission for the reason that the very sketchy and meager showing made in support of such

[8] 49 Cal PUC 494, 85 PUR NS 523.

requested increases of rates was insufficient.

One of the intrastate carriers later filed an amended application with sufficient supporting data to justify the increase which it had requested. The three remaining carriers (the two carriers engaged both in interstate and intrastate commerce) and the other intrastate carrier, notwithstanding the denial by the commission to increase their coach rates, increased the same and began charging the increased rates.

On March 6, 1951, the commission issued an order of investigation against these carriers and, after hearing, granted authority to increase these coach rates effective May 9, 1951, but required the three carriers who had unlawfully increased their rates as of March 1, 1951, to reparate wherever possible to passengers for the increased charge between March 1 and May 9, 1951. (50 Cal PUC 563.) Thus was squarely presented the issue of the authority of the commission over the intrastate rates and charges of these three air carriers. No claim was made by the commission that it had authority over any other subjects of regulation applicable to air carriers.

THEREAFTER, two of these air carriers (both of which were engaged in interstate and intrastate commerce) sought review of the commission's decision before the supreme court of California, the only state court having any jurisdiction over the action of the commission, and that court denied, without a written opinion, the petition for review. Then, these two carriers sought review by way of appeal to the Supreme Court of the United States and, upon motion to dismiss the appeal because no substantial Federal question was presented, that court, on January 7, 1952, dismissed, without a written opinion, the appeal.

In addition to the several contentions, heretofore alluded to, the two carriers, who sought to take the case to the Supreme Court of the United States, injected the issue of carriage by them of the United States mails. This fact, they asserted, barred all state jurisdiction because the carriage of the mails was exclusively a Federal matter justifying complete occupation of the entire field of air transportation. All the carriers contended before the commission and in the proceedings thereafter taken that neither the Constitution of California nor any statute granted to the commission any regulatory authority over air carriers. The commission contended and the courts agreed that the California Constitution grants to the commission rate regulatory and reparation jurisdiction over transportation companies, which are common carriers and public utilities, and that air carriers are, under said Constitution, that type of a transportation company.

I WILL not undertake to discuss the full details of this controversy and the litigation arising therefrom because time will not permit, but I do commend to your attention the decision of the commission on the subject appearing in 50 Cal PUC at page 563 *et seq.*

Applying the principle of the celebrated statement of John P. Curran to this Federal-state conflict of jurisdictions, I assert that "Eternal vigilance is the condition upon which the Federal Constitution has permitted the several states their liberty of action in the intrastate field." This assertion may not be, in a technical sense, an exact statement of the law because the Federal Constitution did not grant anything to the states which they did not then possess but, as a practical matter, I contend that my assertion is regrettably correct and, Ladies and Gentlemen, I appeal to history and the sore experience of the several states for the justification and proof of the integrity and rectitude of my statement.

Responsibility of Utility Management with Respect To Depreciation

By CLARENCE H. ROSS*

ONE of the important responsibilities of utility management is the maintenance of the integrity of utility investment. An important problem faced by utility management in this respect is that of obtaining recognition of adequate depreciation allowances in rate-making proceedings. By and large it does not seem to me that utility management is discharging its full obligation in this regard. I believe this failure is due partly to a lack of recognition of the problem. Accordingly, I shall attempt to describe this problem.

Depreciation Deficiency of All Corporations (U.S.) for 1946-1951, Inclusive, Is $4.2 Billion

THE extent of the general problem resulting from basing depreciation on unadjusted original cost was well illustrated by Paul Grady, partner of Price Waterhouse & Co., New York city, in his address before the recent joint accounting conference of the Edison Electric Institute and the American Gas Association. (Mr. Grady's address was published in the June 19 and July 3, 1952, issues of PUBLIC UTILITIES FORTNIGHTLY.) Mr. Grady introduced a table showing the difference between historical dollar cost and current dollar cost of depreciation for all corporations for the years 1946 to 1951, inclusive, as computed by Dr. George Terborgh. This is Table I (page 603). By reference thereto you will note that the depreciation adjustment passed the 4 billion mark in 1951. This table indicates a 46 per cent overstatement of reported profits in relation to real wealth produced over this 6-year period.

This item of $4.2 billion of depreciation expense was incurred without its recognition as such in corporate accounts.

This underaccrual of depreciation is a very much more important problem to regulated utilities than it is to industry generally. In general industry, deficiencies in depreciation not included in and recognized as an operating expense can be made up to a substantial extent by the accrual of reserves of surplus through an increase in the price of the product. Many authorities believe that, to a large degree, this deficiency in depreciation is being recovered in this manner by general industry.

Depreciation Deficiency of Electric Utilities (U.S.) for 1951 Is $271,000,000

THE procedure of recovering otherwise unrecognized depreciation expense by increasing the price of the product is not available to regulated utilities because the price of the product is directly determined by the recognized costs of production. No cost which is not directly recognized as an expense can be taken into account by regulatory authorities in setting rates. Thus, it is impossible to make any accruals for the cost of depreciation other than that amount recognized and allowed as an expense for such purpose by regulatory authorities. The problem of this underaccrual of depreciation is also, of course, of much greater importance to utilities than to general industry because of a high relative ratio of plant investment to annual revenue.

An indication of the magnitude of the problem of underdepreciation with respect to electric utilities is shown by Mr. Grady in Table II (page 604). Mr. Grady comments as follows with respect to this table:

> The so-called historical results are taken from the preliminary estimates of the Edison Electric Institute. The current dollar results are after increasing depreciation $271,000,000, of which $245,000,000 is applicable to

*Member, Chicago, Illinois, bar.

electric plant and $26,000,000 is applicable to other utility plant owned by class A and B electric utilities. The adjustment of depreciation, amounting to slightly more than 50 per cent of the original cost provisions, is undoubtedly on the low side for two reasons: First, the Consumers' Price Index of the Bureau of Labor Statistics used to convert the property and depreciation accounts to current dollars is lower than utility construction price levels and, second, utility plant accounts were not aged by year of installation prior to 1941, all of such property being converted on the basis of the 1940 index.

Difference between Adjusted and Unadjusted Original Cost Depreciation for 1951 of The Peoples Gas Light & Coke Company (Chicago) Is $2,201,963

I now want to turn to the impact of this problem on a particular company, The Peoples Gas Light & Coke Company, of Chicago. I wish to refer you to a comparison of 1951 Peoples Company costs with original costs of specific sizes and kinds of mains, services, and meters, as shown in Table III (page 605), which was introduced as an exhibit by the Peoples Company in its pending rate case before the Illinois Commerce Commission.

Note that these three classifications of property in service at June 30, 1951, had an original cost of $66,122,750, or 44 per cent of the total original cost of the plant accounts of the Peoples Company at June 30, 1951.

I wish to call your attention to the item of 879,468 5-light meters, which are the ordinary tin gas meters you will find in your own basement. As shown by this table, these meters had an undepreciated original cost at June 30, 1951, of $6,435,-148.38. They constituted 4.4 per cent of the depreciable plant account of the Peoples Company at that date.

During the years 1935-39, inclusive, the Peoples Company installed 65,031 of these meters at an average cost of $8.51, making a total original cost of $553,701. These meters have an average service life of forty-five years, resulting in an annual amortization or depreciation rate of 2.22 per cent on the basis of such average service life. On an unadjusted origi-

TABLE I

NATIONAL INCOME ORIGINATING IN CORPORATE BUSINESS
(MILLIONS OF DOLLARS)

	1946	*1947*	*1948*	*1949*	*1950*	*1951 (Preliminary)*
Income originating in corporate business	$87,171	$105,833	$121,408	$117,684	$132,245	*
Compensation of employees	68,884	81,220	89,993	87,392	96,547	*
Net interest	470	605	570	660	548	*
Corporate profits before tax	23,010	29,765	32,896	27,495	40,276	$44,500
Corporate profits tax liability	9,583	11,940	13,028	10,989	18,593	26,600
Corporate profits after tax	13,427	17,825	19,868	16,506	21,683	17,900
Inventory valuation adjustment	— 5,193	— 5,757	— 2,051	+ 2,137	— 5,126	— 1,500
Depreciation adjustment	— 1,312	— 2,106	— 2,840	— 2,709	— 3,330	— 4,200
Total overstatement in reported profits	6,505	7,863	4,891	572	8,456	5,700
Adjusted profits	6,922	9,962	14,977	15,934	13,227	12,200
Per cent of overstatement in relation to adjusted profits for six years			46%			

*Data not available.

Source: Department of Commerce ("National Income—1951 Edition") except for information on depreciation adjustment which was estimated by Dr. George Terborgh of Machinery & Allied Products Institute.

nal cost depreciation basis the Peoples Company recovers 2.22 per cent of $553,701 in each year with respect to these 65,031 meters, or $12,292. The service capacity of these 65,031 meters is consumed in each year at the rate of 2.22 per cent, resulting in an annual consumption equivalent to 1,443.68 complete meters. Thus, the Peoples Company received $12,292 during the year 1951 from its customers as compensation for the consumption of 1,443.68 meters installed at a cost of $8.51 each.

If these meters could be replaced for $8.51 no problem would arise. The actual fact is that during the year 1951 the Peoples Company replaced this exact type of meter at an average cost of $15.98 each, or a total cost for the 1,443.68 meters of $23,070. As it received only $12,292 from its customers for this purpose, additional capital of $10,778 was required during the year 1951 to replace these meters. If the Peoples Company is required to replace such meters at $15.98 each during the remaining thirty-four

TABLE II

ELECTRIC UTILITIES IN THE UNITED STATES

(A AND B ELECTRIC UTILITIES)

Income Statement

Year Ending December 31, 1951

(In Millions of Dollars)

	In Current Dollars	*In Historical Dollars (Preliminary Estimate By EEI)*
Revenues	$4,960	$4,960
Operating expenses	2,367	2,367
Depreciation	725	480
Taxes	1,137	1,137
Total revenue deductions	4,229	3,984
Electric operating income	731	976
Income other departments before depreciation	129	129
Depreciation	76	50
Income from other departments	53	79
Other income	65	65
Gross corporate income	849	1,120
Interest—long-term debt	284	284
Amortization and other deductions (net)	24	24
Total deductions from gross income	308	308
Net income	$ 541	$ 812
Plant and Capitalization		
Utility plant	$35,658	$23,600
Depreciation reserve	7,199	4,765
Capitalization	29,958	20,334
Earnings Ratios		
Ratio gross income to average capitalization	3.01%	5.72%
Ratio of current dollar gross income to average historical dollar capitalization		4.34%

Note: Plant and depreciation adjustments to reflect current dollars are based on monthly averages of Consumers' Price Index—Bureau of Labor Statistics. No adjustments made for price level changes prior to 1940.

TABLE III

The Peoples Gas Light and Coke Company

COMPARISON OF 1951 COMPANY COSTS WITH ORIGINAL COSTS

of

SPECIFIC SIZES AND KINDS OF MAINS, SERVICES AND METERS

	Description (A)	Quantity in Service at June 30, 1951 (B)	Property in Service at June 30, 1951 (C)	Average Unit Cost — 1951 Company Costs: For all Installations (D)	For all Purchases (E)	For Installations of 1000' or More (F)	Property in Service at June 30, 1951: Original Cost (G)	Computed Total Based on Actual Company Costs in 1951 (H) (Note 1)
Mains								
	6 Inch Cast Iron	13,442,176 feet	$ 1.53	$ 4.47	$	$ 4.37	$20,533,442.24	$58,742,309.12
	8 Inch Cast Iron	842,878 feet	2.05	8.02		5.73	1,730,763.73	4,829,670.94
	12 Inch Cast Iron	1,170,731 feet	4.34	10.72		10.38	5,076,368.80	12,152,187.78
	16 Inch Cast Iron	550,166 feet	6.23	15.42		14.37	3,429,422.64	7,905,885.42
	20 Inch Cast Iron	423,881 feet	8.40	22.62		19.43	3,561,968.93	8,236,007.83
	24 Inch Cast Iron	576,297 feet	10.10	22.92		22.62	5,819,974.43	13,035,838.14
Services								
	1-1/4 Inch Copper	2,335,588 feet	1.79	2.53			4,170,910.80	5,909,037.64
	1-1/2 Inch Steel	15,412,432 feet	.80	1.89			12,329,078.25	29,129,496.48
	2 Inch Steel	845,730 feet	1.31	3.79			1,105,334.79	3,205,316.70
	4 Inch Steel	68,309 feet	4.48	7.89			305,725.93	538,958.01
	6 Inch Steel	35,213 feet	8.50	11.41			299,451.13	401,780.33
	8 Inch Steel	16,555 feet	10.91	13.51			180,576.81	223,658.05
Meters								
	5 Light	879,468	7.32		15.98		6,435,148.38	14,053,898.64
	10/300	73,595	15.55		23.03		1,144,583.14	1,694,892.85
							$66,122,750.00(2)	$160,058,957.93

Note (1) Mains are computed at Average Unit Cost for Installations of 1000' or more.
(2) Represents approximately 44% of total original cost at 6-30-51
(Totals for Columns G and H and Note 2 not included in Exhibit as submitted, but added for this presentation)

years of life, the Peoples Company will in each year continue to have a difference of $10,778, or a total difference of $366,452 over the service life of the 65,031 meters between the accruals and the cost. This constitutes a confiscation of capital.

TABLE IV

ASSUMPTION: PURCHASING POWER WILL BE STABILIZED AT 1951 LEVEL FOR NEXT THIRTY YEARS

Assume $40,000 is invested in January, 1940, in depreciable utility property having a 40-year life, resulting in annual depreciation requirement of $1,000 (assuming no salvage). If only 1,000 then current dollars for each of the years 1952-79, inclusive, are received with respect to depreciation expense, a cumulative deficit of $16,057 in terms of January, 1940, dollars will result, based upon the foregoing assumption. $12,880 of this $16,057 deficit will accrue after January 1, 1952, even on the assumption of the stabilization of the June 15, 1951, price level.

(1) Year	(2) U. S. Dept. Of Labor Consumers' Price Index 1935-39=100	(3) Purchasing Power in Cents of Dollar Current in Each Year	(4) Current Dollars Required to Equal $1,000 in January, 1940, Dollars	(5) Deficiency Per $1,000 of Annual Allowance for Depreciation Expressed in January, 1940, Dollars
January, 1940	100	100 ¢		
1940	100.2	99.8	$1,002	$ 2
1941	105.2	95.0	1,052	50
1942	116.6	85.7	1,166	143
1943	123.7	80.8	1,237	192
1944	125.7	79.6	1,257	204
1945	128.6	77.8	1,286	222
1946	139.5	71.7	1,395	283
1947	159.6	62.7	1,596	373
1948	171.9	58.2	1,719	418
1949	170.2	58.8	1,702	412
1950	171.9	58.2	1,719	418
6-15-51	185.2	54.0	1,852	460
1952	185.2	54.0	1,852	460
1953	185.2	54.0	1,852	460
1954	185.2	54.0	1,852	460
1955	185.2	54.0	1,852	460
1956	185.2	54.0	1,852	460
1957	185.2	54.0	1,852	460
1958	185.2	54.0	1,852	460
1959	185.2	54.0	1,852	460
1960	185.2	54.0	1,852	460
1961	185.2	54.0	1,852	460
1962	185.2	54.0	1,852	460
1963	185.2	54.0	1,852	460
1964	185.2	54.0	1,852	460
1965	185.2	54.0	1,852	460
1966	185.2	54.0	1,852	460
1967	185.2	54.0	1,852	460
1968	185.2	54.0	1,852	460
1969	185.2	54.0	1,852	460
1970	185.2	54.0	1,852	460
1971	185.2	54.0	1,852	460
1972	185.2	54.0	1,852	460
1973	185.2	54.0	1,852	460
1974	185.2	54.0	1,852	460
1975	185.2	54.0	1,852	460
1976	185.2	54.0	1,852	460
1977	185.2	54.0	1,852	460
1978	185.2	54.0	1,852	460
1979	185.2	54.0	1,852	460
				$16,057

APPENDIX

ANOTHER important category of property of the Peoples Company covered in this table is that of service pipe. Out of a total of 19,516,616 feet of service pipe in plant account at June 30, 1951, 15,412,432 feet consisted of 1¼-inch steel service pipe. These services had an undepreciated original cost at June 30, 1951, of $12,329,078.25, constituting 8.5 per cent of the depreciable plant account at that date. During the year 1935-39, inclusive, the Peoples Company installed 1,626,442 feet of such services at an average cost of $1.04 per foot. During the year 1951 the Peoples Company installed 603,632 feet of such services at an average cost of $1.89 per foot. It is again apparent that an original cost depreciation allowance on the basis of $1.04 per foot will not permit the Peoples Company to restore equivalent service capacity at a cost of $1.89 per foot. This extra cost, as in the case of meter replacement, is not allowed as an expense by regulatory authorities in the income and expense account of the Peoples Company.

TABLE V

ASSUMPTION: PURCHASING POWER WILL BE RESTORED TO JANUARY, 1940, LEVEL AT 1-1-1963 IN EQUAL ANNUAL INCREASES BETWEEN 1951 AND 1963 AND WILL STABILIZE AT THE 1-1-1963 LEVEL FOR THE SUCCEEDING SEVENTEEN YEARS

Assume $40,000 is invested on January 1, 1940, in depreciable utility property having a 40-year life, resulting in annual depreciation requirement of $1,000 (assuming no salvage). If only 1,000 then current dollars for each of the years 1952-79, inclusive, are received with respect to depreciation expense, a cumulative deficit of $5,817 in terms of January, 1940, dollars will result, based upon the foregoing assumption. $2,640 of this $5,817 deficit will accrue after January 1, 1952, even on the assumption of the restoration of the 1935-39 price level as of January 1, 1963.

(1) *Year*	*(2)* *U. S. Dept. Of Labor Consumers' Price Index 1935-39=100*	*(3)* *Purchasing Power in Cents of Dollar Current in Each Year*	*(4)* *Current Dollars Required to Equal $1,000 in January, 1940, Dollars*	*(5)* *Deficiency Per $1,000 of Annual Allowance for Depreciation Expressed in January, 1940, Dollars*
January, 1940	100	100 ¢		
1940	100.2	99.8	$1,002	$ 2
1941	105.2	95.0	1,052	50
1942	116.6	85.7	1,166	143
1943	123.7	80.8	1,237	192
1944	125.7	79.6	1,257	204
1945	128.6	77.8	1,286	222
1946	139.5	71.7	1,395	283
1947	159.6	62.7	1,596	373
1948	171.9	58.2	1,719	418
1949	170.2	58.8	1,702	412
1950	171.9	58.2	1,719	418
6-15-51	185.2	54.0	1,852	460
1952	178.6	56	1,786	440
1953	166.7	60	1,667	400
1954	156.3	64	1,563	360
1955	147.0	68	1,470	320
1956	138.9	72	1,389	280
1957	131.6	76	1,316	240
1958	125.0	80	1,250	200
1959	119.0	84	1,190	160
1960	113.6	88	1,136	120
1961	108.7	92	1,087	80
1962	104.2	96	1,042	40
1-1-63	100	100	1,000	—o—
				$5,817
1-1-63-79	100	100	1,000	—o—

WHY did I pick these two categories of property for the purpose of this illustration? Because the current consumption of the service capacity of these items is obviously being restored by the installation of substantially identical items and because between the years 1935-39 and 1951 there was no material difference in the methods or conditions under which such installations were made, and because also they illustrate the situation generally prevailing in respect to the true cost of depreciation of the Peoples Company's property in its entirety. It is very interesting to note with respect to these two categories of meters and services that the 1951 cost as compared with the 1935-39 cost in the case of meters is 187 per cent and in the case of services is 181 per cent. This compares with the reciprocal, or approximately 185 per cent, of the 1951 purchasing power of the dollar (54 cents) based on the 1935-39 100-cent dollar.

The third category of property shown on Table III is cast-iron mains. As will be noted from the table, the replacement cost in 1951 of the $20,533,442 of original cost of 6-inch cast-iron pipe is $58,742,309.

THE Peoples Company has computed its over-all difference between adjusted and unadjusted original cost depreciation expense for the year 1951 by the use of the Consumers' Price Index for Moderate Income Families in Large Cities (1935-39=100) of the Bureau of Labor Statistics, 1913-June 15, 1951, as extended back from 1913 through 1850 by the Federal Reserve Bank of New York. By the use of this index the Peoples Company converted the original cost of all of its depreciable property to 1935-39 dollars, arriving at a figure of $139,257,320. Applying straight-line depreciation rates to this original cost, the annual amortization in terms of the 1935-39 dollar was computed at $2,979,937. This amount converted into June 15, 1951, dollars by the use of the aforesaid index results in a depreciation requirement of $5,518,843. Applying the same straight-line rates of depreciation to the orthodox original cost base results in a depreciation requirement of $3,316,880. Five million, five hundred and eighteen thousand, eight hundred forty-three dollars less $3,316,880 results in a difference of $2,201,963.[1]

Tables Showing Depreciation Deficiencies Resulting from Various Assumptions of Future Price Levels

FROM what I have said so far it might be assumed that I am resting my case on a forecast of rising price levels in the future. None of us knows whether the purchasing power of the dollar in the future will be 25 cents, 50 cents, or some other amount in terms of the 1935-39 Consumers' Price Index dollar. In my opinion the present need for adjusting depreciation allowances does *not* depend on a forecast of rising price levels in the future. In illustration of this fact I wish now to refer you to four depreciation tables which were presented by Dr. George Terborgh in the pending rate case of the Peoples Company before the Illinois Commerce Commission.

These depreciation tables involve 40-year assets, a service life somewhat typical of gas utility properties, and use as a measure of price level changes, the aforesaid Consumers' Price Index of the United States Bureau of Labor Statistics. In each table he assumes the investment in January, 1940, of $40,000 in depreciable utility property having a service life of forty years. Original cost depreciation is, therefore, $1,000 annually, assuming no salvage. The purpose of these examples is (1) to indicate, under various assumptions as to future price levels, how many of the then current dollars in each of the years 1952-79, inclusive, must be collected to equal the purchasing pow-

[1] A difference of only $1,321,000 was actually claimed for rate-making purposes, which is the portion of the total difference accruing with respect to the property represented by equity capital. For practical considerations, the description of which is beyond the scope of this paper, it was deemed unwise to claim that part of the difference arising with respect to the portion of the property represented by funded debt.

TABLE VI

ASSUMPTION: PURCHASING POWER WILL BE RESTORED TO JANUARY, 1940, LEVEL AT 1-1-1963 IN EQUAL ANNUAL INCREASES BETWEEN 1951 AND 1963 AND ALSO THE CUMULATIVE EXCESS BETWEEN 1963 AND 1979 WILL EQUAL THE CUMULATIVE DEFICIENCY BETWEEN 1940 AND 1963 WITH RESTORATION TO JANUARY, 1940, LEVEL AT 1-1-1980

Assume $40,000 is invested on January 1, 1940, in depreciable utility property having a 40-year life, resulting in annual depreciation requirement of $1,000 (assuming no salvage). If only 1,000 then current dollars for each of the years 1952-79, inclusive, are received with respect to depreciation expense, the economic cost will be recovered.

(1) Year	(2) U. S. Dept. Of Labor Consumers' Price Index 1935-39=100	(3) Purchasing Power in Cents of Dollar Current in Each Year	(4) Current Dollars Required to Equal $1,000 in January, 1940, Dollars	(5) Deficiency Per $1,000 of Annual Allowance for Depreciation Expressed in January, 1940, Dollars
January, 1940	100			
1940	100.2	99.8¢	$1,002	$ 2
1941	105.2	95	1,052	50
1942	116.6	85.7	1,166	143
1943	123.7	80.8	1,237	192
1944	125.7	79.6	1,257	204
1945	128.6	77.8	1,286	222
1946	139.5	71.7	1,395	283
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1949	170.2	58.8	1,702	412
1950	171.9	58.2	1,719	418
6-15-51	185.2	54	1,852	460
1952	178.6	56	1,786	440
1953	166.7	60	1,667	400
1954	156.3	64	1,563	360
1955	147.0	68	1,470	320
1956	138.9	72	1,389	280
1957	131.6	76	1,316	240
1958	125.0	80	1,250	200
1959	119.0	84	1,190	160
1960	113.6	88	1,136	120
1961	108.7	92	1,087	80
1962	104.2	96	1,042	40
1-1-63	100	100	1,000	—o—
				$5,817
1963	93.4	107.1¢	$ 934	$ *71*
1964	87.5	114.3	875	*143*
1965	82.3	121.5	823	*215*
1966	77.7	128.7	777	*287*
1967	73.6	135.9	736	*359*
1968	69.9	143.1	699	*431*
1969	66.5	150.3	665	*503*
1970	63.5	157.5	635	*575*
1971	60.7	164.7	607	*647*
1972	63.5	157.5	635	*575*
1973	66.5	150.3	665	*503*
1974	69.9	143.1	699	*431*
1975	73.6	135.9	736	*359*
1976	77.7	128.7	777	*287*
1977	82.3	121.5	823	*215*
1978	87.5	114.3	875	*143*
1979	93.2	107.3	932	*73*
1-1-1980	100	100	1,000	
				$5,817

er equivalent of 1,000 January, 1940, dollars, and (2) to indicate the cumulative deficits in terms of January, 1940, dollars if only 1,000 then current dollars are received in each of such years.

TABLE *IV assumes a stabilized dollar at June 15, 1951.* I first refer you to Table IV (page 606) under which it is assumed that the purchasing power of the dollar will be stabilized at the June 15, 1951, level for the succeeding thirty years. This table is presented to meet the thinking of those who assume, if the dollar's purchasing power is now stabilized, that in this event everything will be all right.

Turning to Table IV, we note that column (1) comprises the years covered by the table. Under column (2) we find the Consumers' Price Index of the United States Department of Labor. (Since the January, 1940, level of the index, 99.5, was so close to 100, we have assumed it was exactly that in order to show the index on its customary 1935-39 base.) On June 15, 1951, the index stood at 185.2, which level is assumed as constant for the balance of the years 1952 to 1979. In column (3), under the heading "Purchasing Power in Cents of Dollars Current in Each Year," is set forth the purchasing power of the dollar in each of the years 1940-79, which is the reciprocal of the index figure in column (2). This column shows the purchasing power of the dollar to be 54 cents as of June 15, 1951. In column (4) we have the number of current dollars needed each year to equal in purchasing power the 1,000 January, 1940, dollars that are required for a realistic depreciation allowance. Finally, we have in column (5) the deficiency arising from the annual depreciation allowance of 1,000 current dollars. As indicated by the table, the cumulative deficiency over the life of the property is 16,057 of such dollars. This means that of an original investment of 40,000 January, 1940, dollars, only 23,943 are recovered through depreciation. It should be noted that $12,880 of the $16,057 deficiency accrues after 1951, even on the assumption of the stabilization of the June 15, 1951, price level.

This table, in my opinion, demonstrates that the present need for adjusting depreciation allowances does not depend on the assumption of rising price levels in the future.

TABLE *V assumes 1940 dollars restored on January 1, 1963, and stabilized at that date.* Many believe that the present inflation is only temporary and that it will be succeeded by a depression when and if we reach times of peace. Some believe it possible that the purchasing power of the dollar may be restored to its 1939 level or even higher. Even under this cycle, however, there is nevertheless a present need for adjusting depreciation allowances. I refer to Table V (page 607), which assumes that the purchasing power of the dollar will be restored to the January, 1940, level in the same length of time and at the same average rate as the decline in such purchasing power for the period 1940 to June 15, 1951.

On the assumption of this table the purchasing power of the dollar will be restored to 100 cents on January 1, 1963, and will be stabilized at that level for the succeeding seventeen years. This table follows exactly the same form as Table IV down to and including June 15, 1951, but owing to the assumption of the increasing purchasing power of the dollar during the years 1952-62, inclusive, the respective deficiencies in the annual allowance for depreciation end as of January 1, 1963, after which there are no further deficiencies. Under the assumption of this example, property with a 40-year life installed through the investment of 40,000 dollars in January, 1940, will accumulate a deficiency in depreciation over its lifetime in the amount of 5,817 original dollars. Of this $5,817 deficit, $2,640 will accrue after January 1, 1952, even on the assumption of the restoration of the original price level as of January 1, 1963.

This table, in my opinion, clearly establishes that a return to the original cost price level following a period of inflation will not offset depreciation deficiencies

occurring during the period of inflation when price levels are above the original cost price level.

TABLE *VI assumes sufficient increase of purchasing power to restore 1951 deficiency.* It would be possible, of course, to assume that after the original cost price level of January 1, 1940, had again been reached on January 1, 1963, there would be a further increase in the purchasing power of the dollar sufficient to offset the depreciation deficiency occurring in the period when prices were above the original cost level. I refer you to Table VI (page 609), which is really a continuation of Table V. This table starts with the same assumption as Table V that the purchasing power of the dollar is restored to the January, 1940, level over the same length of time and at the same average rate as it declined. On this assumption its purchasing power comes back to 100 cents by January 1, 1963. Table VI then assumes that following this date its purchasing power increases so that the cumulative excess of depreciation accruals between 1963 and 1979 equals the cumulative deficiencies suffered between 1940 and 1962. Specifically, the deficiency of 5,817 January, 1940, dollars suffered during the period 1940-62 is offset during the period 1963-79. Under the highly improbable assumptions embodied in the table, the excess depreciation of the period 1963-79 of course offsets in aggregate amount the deficiency of 1940-62. This complete offset is, however, illusory because of the time factor. The recovery, without interest, in the later period of the deficiency incurred in the earlier one is not a full recovery, for the owner of property has lost the use of the funds in the interval.

TABLE *VII assumes a continuing decline in the purchasing power of the dollar.* In the next table we have assumed that the purchasing power of the dollar will decline at the same rate from 1951 to 1963 as that experienced from 1940 to 1951 and then stabilize at the 1963 level. This Table VII (page 613) is, therefore, the same as Tables IV, V, and VI down to June 15, 1951. As indicated, the total cumulative deficiency shown in Table VII under these assumptions is 22,247 January, 1940, dollars. Of this total, $19,070 accrues after January 1, 1952.

These tables demonstrate, in my opinion, that there is no future trend of prices with the slightest degree of probability that will offset hereafter the deficiencies now being incurred in depreciation of long-life assets acquired at substantially lower levels. This clearly indicates the present need for adjusting depreciation allowances.

Charles W. Smith, in discussing this question of depreciation deficiencies in his testimony in Washington Public Service Commission *v.* Washington Water Power Co., Cause No. U-8398, says (Tr. 1002):

> . . . as the additional cost [because of underaccrual of depreciation] is incurred, it is charged to plant and thus becomes a part of the rate base. The additional investment is therefore protected both as to depreciation and as to fair return.

MR. SMITH is very careful to say that the *additional* investment is protected. This, of course, is only so under the assumption that the average purchasing power of the dollar received in the future with respect to depreciation is equivalent to the purchasing power of the dollar representing such additional investment. The 1940 investor is not now being protected and Mr. Smith does not even claim that he is. The only way that the 1940 investor can be protected is under the highly improbable assumptions (i) that in the future the purchasing power of the dollar will increase sufficiently over the remaining life of the property to make up for the underaccrual of depreciation from 1940 to date, and (ii) that regulatory authorities will not reduce the rate of depreciation in recognition of the fact that the purchasing power of the dollar received in times of depression may be twice as great as the purchasing power of the dollar invested in depreciable property.

Does the Burden of Depreciation Deficiencies Fall on the Investor or the Consumer?

THERE seems to be an impression that these uncontrovertible depreciation deficiencies are not of serious moment. Some assume it is only a question of whether present or future customers pay the bill; that investors are not involved. As one writer said recently:

> . . . increased depreciation charges to compensate for inflation are not primarily an issue between the utility and the consumer, but between present consumers and future consumers. If present consumers do not replace the physical capital used up, investors must do so and future consumers must pay for it.

This implies that neither the corporation nor the investors therein suffer as a result of the failure to provide adequate depreciation. This is not the case. While future consumers, assuming a stabilized dollar, will return the investment of the future investors, the past investor is left high and dry. Until we do have a stabilized currency the future consumers will not even pay for the depreciation of the property purchased by the future investors.

This proposition is, I believe, made clear by the following illustration:

Any Sustained Decline in the Purchasing Power of the Dollar Following Investment Prevents Full Recovery through Original Cost Depreciation

SUPPOSE a corporation on December 31, 1939, installed 200 telephone poles at a cost of $5 per pole, or $1,000, and that to finance this plant account it sold 200 shares of common stock at $5 per share. Assume that the poles had a life of ten years and that each pole lived its allotted life span and no more, without salvage. The 1940 plant and capital accounts would be as follows:

1940 Plant Account	
200 poles at $5 each	$1,000
1940 Capital Account	
200 (1940) shares at $5 each	$1,000

The 200 (1940) shares represent the ownership of 200 poles.

ASSUME that on January 1, 1940, by governmental action, the purchasing power of the dollar was cut to 50 cents for all purposes. During the years 1940-50 the corporation accrues (on an original cost basis) $1,000 for depreciation, but as new poles in 1950 cost $10 each, the depreciation accruals will buy only 100 poles. In order to keep its plant account intact the corporation, at December 31, 1949, is required to issue 200 additional shares of common stock to buy 100 additional poles. The 1950 plant and capital accounts are as follows:

1950 Plant Account	
100 new poles at $10 each paid for by depreciation accruals	$1,000
100 new poles at $10 each paid for by issuing 200 (1950) shares at $5 each	1,000
Total	$2,000
1950 Capital Account	
200 (1940) shares at $5 each.....	$1,000
200 (1950) shares at $5 each.....	1,000
Total	$2,000

The 200 (1940) shares in 1950 represent the ownership of 100 poles, not 200 as in 1940. The 200 (1950) shares in 1950 represent the ownership of 100 poles.

ASSUME that on January 1, 1950, by governmental action, the purchasing power of the dollar was cut to 25 cents for all purposes. During the years 1950-60, the corporation will accrue (on an original cost basis) $2,000 for depreciation, but as new poles in 1960 will cost $20 each, the depreciation accruals will buy only 100 poles. In order to keep the plant account intact the corporation will, therefore, on December 31, 1959, have to issue 400 additional shares at $5 each to buy 100 additional poles. The 1960 plant and capital accounts will then be as follows:

1960 Plant Account	
100 poles at $20 each paid for by depreciation accruals	$2,000
100 poles at $20 each paid for by is-	

suing 400 (1960) shares of stock at $5 each	2,000
Total	$4,000
1960 Capital Account	
200 (1940) shares at $5 each	$1,000
200 (1950) shares at $5 each	1,000
400 (1960) shares at $5 each	2,000
Total	$4,000

The 200 (1940) shares in 1960 represent the ownership of 50 poles, not 200 as in 1940. The 200 (1950) shares in 1960 will represent the ownership of 50 poles, not 100 as in 1950, and the 400 (1960) shares represent the ownership of 100 poles.

THE investor in 1940 dollars, or in 1950 dollars, or in 1960 dollars would, in each case, have recovered full depreciation had the dollar been stabilized from and after the period of its investment. This simple illustration does, however, make it very clear that any sustained decline in the purchasing power of the dollar following the investment

TABLE VII

ASSUMPTION: PURCHASING POWER WILL DECLINE AT SAME RATE FROM 1951 TO 1963 AS OCCURRED FROM 1940 TO 1951 AND WILL STABILIZE AT THE 1-1-1963 LEVEL FOR THE SUCCEEDING SEVENTEEN YEARS

Assume $40,000 is invested on January 1, 1940, in depreciable utility property having a 40-year life, resulting in annual depreciation requirement of $1,000 (assuming no salvage). If only 1,000 then current dollars for each of the years 1952-79, inclusive, are received with respect to depreciation expense, a cumulative deficit of $22,247 in terms of January, 1940, dollars would result, based on the foregoing assumption. $19,070 of this $22,247 deficit will accrue after January 1, 1952.

(1)	*(2)*	*(3)*	*(4)*	*(5)*
Year	*U. S. Dept. Of Labor Consumers' Price Index 1935-39=100*	*Purchasing Power in Cents of Dollar Current in Each Year*	*Current Dollars Required to Equal $1,000 in January, 1940, Dollars*	*Deficiency Per $1,000 of Annual Allowance for Depreciation Expressed in January, 1940, Dollars*
January, 1940	100			
1939	99.4	100.6¢		
1940	100.2	99.8	$1,002	$ 2
1941	105.2	95.0	1,052	50
1942	116.6	85.7	1,166	143
1943	123.7	80.8	1,237	192
1944	125.7	79.6	1,257	204
1945	128.6	77.8	1,286	222
1946	139.5	71.7	1,395	283
1947	159.6	62.7	1,596	373
1948	171.9	58.2	1,719	418
1949	170.2	58.8	1,702	412
1950	171.9	58.2	1,719	418
6-15-51	185.2	54.0	1,852	460
1952	196.1	51	1,961	490
1953	204.1	49	2,041	510
1954	212.8	47	2,128	530
1955	222.2	45	2,222	550
1956	232.6	43	2,326	570
1957	243.9	41	2,439	590
1958	256.4	39	2,564	610
1959	270.3	37	2,703	630
1960	285.7	35	2,857	650
1961	303	33	3,030	670
1962	322.6	31	3,226	690
1-1-63	344.8	29	3,448	710
				$10,377
1-1-63-80	344.8	29	$59,296	11,870
				$ 22,247

prevents full recovery through original cost depreciation.

This illustration shows, moreover, that to the extent property is not replaced through depreciation accruals it must be replaced by the use of the proceeds of new capital. It has been contended that the laws of Illinois, New York, and certain other states forbid the use of the proceeds of new capital for the replacement of utility property and that original cost depreciation results in such replacement.

Accountability of Management during Inflation

I BELIEVE I have established the proposition that, as a result of original cost depreciation, all utility equity investors suffer confiscation in the event the dollar continues to depreciate after they have made their investment. So long, however, as inflation continues I do not believe there is much likelihood that management will be called to account for its failure to recover full economic depreciation. It is entirely possible that the continuance of inflation at the rate suffered during the past several years will not create a serious financial problem for utility corporations. There is no evidence to date that the failure to recover full economic depreciation under such circumstances will impair materially the financial credit of public utilities or their ability to raise equity capital by the sale of additional stock at book value. When and to the extent it does, regulatory commissions will probably meet the issue by providing a rate of return high enough to attract capital.

The reason inflation has not impaired corporate credit materially is explained by Professor Walter A. Morton in "Rate of Return and the Value of Money in Public Utilities," published in the May, 1952, issue of *Land Economics*. Discussing Professor Bonbright's testimony in a recent rate case of the Wisconsin Telephone Company, Professor Morton said (page 117):

> We can now quickly dispense with the argument that inflation protection is required to attract new capital. The need for such protection, we must agree with Professor Bonbright, has not been established. But we can go further and say that it cannot be established.
>
> However desirable such protection may be as a matter of fairness, it certainly is not necessary. The new purchaser comes with an inflated dollar to buy prospective income in inflated dollars. The old investor is helpless because his capital is already committed; the new investor looks to the present and future, and is not concerned with past injustices. Although original investors may, in fact, lose much real value, the new investor will buy shares so long as the yield is satisfactory. This is nothing new. It has always been so throughout the history of regulation. The owner of property has had to appeal to the courts, not to the market to protect him from confiscation.
>
> So long as the nominalistic historical cost—cost-of-money method of rate making prevails, nothing stands in the way of continuous expropriation of past investors by means of a fall in the value of money. Furthermore, new inflated dollars will always be forthcoming at a satisfactory current yield, except perhaps during times of galloping inflation. Consistently applied, this doctrine reduces the equity owner to a creditor in perpetuity who has no more protection against loss by inflation than any holder of obligations payable in money. It assumes he has a choice in action, not a title to property. In one respect the common stockholder is put into an even weaker position than other creditors, for the bondholder can withdraw his capital at maturity date and make a new deal whereas the equity investor is committed for the life of the enterprise.

WHAT he says, in effect, is that the continuous expropriation of past investors will not deter new investments unless and until the new investor loses confidence in the future. Because finan-

cial impairment is suffered by the past investor and because there is no impairment of corporate credit resulting therefrom, corporate managements feel no pain and suffer very little criticism. They have not been and, in my opinion, may not be called to account for their failure to recover full economic depreciation unless and until we have deflation.

Accountability of Management in the Event of Deflation

For the purposes of argument, let us agree that the present inflation and reduced purchasing power of the dollar is really only part of a long-term fluctuation. Let us assume that we are at or near the top of a cycle and that over the next dozen years we will have a depression during which the dollar will be restored to its 1940 purchasing power in terms of the Consumers' Price Index. This, of course, is the assumption of Table V, which also assumes that after the dollar has been restored to its 1940 level, it will be stabilized thereafter.

I think everyone will agree that the purchasing power of the dollar cannot be restored except as a result of a severe and long-continued depression. To stick to unadjusted original cost depreciation in such a period would result in large profits from depreciation accruals by a great many companies. It would mean that a substantial part of the several billions of 54-cent dollars invested in utilities in recent years would be returned twofold as a result of the customers paying for original cost depreciation in 100-cent dollars. I do not believe there is any reasonable possibility that public utility regulatory authorities will adhere to original cost depreciation in a period of severe and prolonged depression. It is not desirable, even if possible, that utility customers during a depression should be required to make up for depreciation deficiencies incurred during times of inflation. This theory runs counter to all regulatory concepts.

I believe in the event of a depression that utility management may be called to account for its failure to make every effort to obtain economic depreciation during inflationary periods. It is not inconceivable that regulatory authorities, in periods of depression, may even require depreciation deficiencies to be made up out of surplus.

Responsibility of Utility Management

My conclusion is, therefore, that utility management is not discharging its full responsibility with respect to utility depreciation until it has made every reasonable effort to establish *adjusted* original cost depreciation as a fixed principle. The failure to establish either (a) *unadjusted* original cost depreciation, or (b) *adjusted* original cost depreciation, means that utility corporations will be given nominal dollar depreciation (*unadjusted* original cost depreciation) in times of inflation and economic depreciation (*adjusted* original cost depreciation) in times of deflation, which is a heads I lose, tails you win, proposition. This will result not only in impairment of the stockholders' investment but might very well result in an impairment of the company's credit.

It is my recommendation that the issue of economic depreciation be presented in rate cases and in court cases so that we can at least get the courts on the line with respect to this problem. It is my belief that when regulatory authorities and the courts understand fully the impact of unadjusted original cost depreciation, particularly in times of depression, that the justice of *adjusted* original cost depreciation will prevail. For the reasons stated above, the enforcement of strict original cost depreciation during times of depression would constitute a very heavy and perhaps an illegal burden on consumers. In Illinois, The Peoples Gas Light & Coke Company, of Chicago, has attacked the propriety of original cost depreciation in its pending rate case. Iowa-Illinois Gas & Electric Company has also attacked the constitutionality of the uniform system of accounts of the Illinois Commerce Commission with respect to the provisions requiring that depreciation be com-

puted on an original cost basis. These cases may very well settle this issue in Illinois.

Original Cost Depreciation Is Not Res Adjudicata

MANY assume that original cost depreciation was made *res adjudicata* by the Hope Gas Case. Others assume that original cost depreciation is a fixed and immutable accounting principle. Neither is the case. If original cost depreciation were *res adjudicata* legally and were a fixed and immutable accounting principle, perhaps utility management need not have but little concern that it will ever be held accountable for its failure to attempt to recover full economic depreciation. It is because this matter is not *res adjudicata* and is not a settled accounting principle that management is in jeopardy in this respect.

As authority for the legal proposition that original cost depreciation is not *res adjudicata,* I refer you to an article entitled "Rate Making and Inflation," by the Honorable John P. Randolph, general solicitor of the National Association of Railroad and Utilities Commissioners, in the July 3, 1952, issue of PUBLIC UTILITIES FORTNIGHTLY. He states that historical cost figures as a basis for the accruing of depreciation have been rendered obsolete by the inroads of inflation. In discussing the legal authorities he says (page 5):

> As is shown by the history of the legal conflict, the basic issue came to be whether rate-making agencies were *required* by the Federal Constitution to give predominant weight to reproduction cost in arriving at a rate base, irrespective of the economic consequences or other considerations. All the Supreme Court has said is that the Constitution does not require any formula (specifically reproduction cost) for a rate base. In this current inflationary period it is important to remember that the court has not said that it is unfair or improper to consider a major change in price levels. This open door is especially important if the change appears to be permanent or of long duration.

On page 8, in discussing the expense of depreciation, he says:

> . . . Another effect of inflation on the expenses of doing business is not quite so obvious but no less serious because it results in overstating even the number of dollars of profit on the books of the utility. This comes about through charging the expenses with an insufficient number of dollars of depreciation accruals *by basing such accruals on historical cost figures which have been rendered obsolete by the inroads of inflation.* (Emphasis supplied.)

It is clear that Judge Randolph does not believe that the Hope Gas Case has made the question of basing depreciation on unadjusted original cost *res adjudicata.*

I ALSO refer you to a powerful article by Arthur H. Dean, a partner of Sullivan and Cromwell, New York city, in the June, 1952, issue of the *Harvard Law Review,* entitled "Provision for Capital Exhaustion under Changing Price Levels." On page 1351 Mr. Dean, in discussing the propriety of using unadjusted original cost as a depreciation base, says:

> But, as all public utilities lawyers know, the *Hope* Case did not say that original cost alone was necessarily controlling or that original cost could not be adjusted to reflect seemingly permanent changes in price levels.

For my authority that original cost depreciation is not a fixed and immutable accounting principle, I refer you to "Changing Concepts of Business Income," constituting a report of the study group on business income organized by the American Institute of Accountants, and to Supplementary Statement No. 2, by the committee on concepts and standards underlying corporation financial statements of the American Accounting Association, published in the October,

1951, issue of the *Journal of Accountancy*, page 461.

The Real Issue

ONE might suppose from my comments on the Peoples Company situation that I would propose that depreciation be based on reproduction cost. This would only be practicable if all utility property were now being, and would continue to be, replaced by similar property. By and large this is not the case in the utility industry. Most utility property is not replaced by identical property. Because of this fact I concur with Mr. Smith and the United States Supreme Court that reproduction cost as a basis for depreciation is generally inappropriate.

Neither do I think that the issue is that of cost *versus* present value. The issue is really whether the depreciation base shall be cost in a stated *quantum* of dollars without modification because of the *quality* thereof, or whether it shall be cost in a stated *quantum* of dollars with recognition of the *quality* thereof. In other words, I think the question is, as I stated before, what is the *original cost* in terms of current dollars of the property consumed, *not* what is the cost in terms of the current dollars of replacing the property.

As long ago as March, 1928, Professor James C. Bonbright, of Columbia University, suggested this theory with respect to rate base in an article entitled "The Economic Merits of Original Cost and Reproduction Cost," in 41 *Harvard Law Review* 593, at page 600:

> It is true that if a choice must be made between prudent investment in its unmodified form and reproduction cost then the former basis is likely to result in a less serious fluctuation of real incomes than is the latter basis. But one should not rest content to make this choice of evils without seeking a way out of the dilemma. A possible way lies open. It is to accept the standard of prudent investment but to make the measure of that investment, not the historical *money* cost but the historical *real* cost. In other words, the rate base might be made to vary, not with changes in the cost of railway construction but rather with changes in an index of the cost of living.

Professor Bonbright was, of course, discussing rate base, not depreciation base, and also it must be remembered that at the time Smyth *v.* Ames was the law of the land.

Responsible accounting authorities agree that the mechanics of providing for economic depreciation present no serious problem. While it is true that not all the authorities agree on the proper method, I do not believe that the question of method presents any serious difficulty. I believe the presentation made by the Peoples Company in its pending rate case presents a practical solution to this problem.

Depreciation—and Inflation

By GEORGE JACKSON EDER*

THE problem under discussion—the impact of inflation on the law governing depreciation accounting — is simple: The fact that present accounting methods, prescribed by the public service commissions, the Bureau of Internal Revenue, and the courts, misrepresent utility earnings to the extent of perhaps a half-billion dollars a year and that, even if costs go no higher than they are today, the investment in public utility stocks has already been confiscated to the extent of over $4 billion.

Solutions to the problem are equally simple. In fact, the only real problem—

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as in so many business situations—is the human element: how best to analyze, solve, and present the problem so as to bring conviction to the hearts and minds of the public utility commissioners, the tax collectors, and the judges—and those gentlemen are hardheaded and hardhearted and not easily moved by the plight of the public utilities and taxpayers.

The Problem

THE typical utility property is a going and growing concern; its accruals to the depreciation reserve are invested in expanding plant, and the various elements of plant wear out and are retired at different times.

To simplify the problem, let us take the case of a utility that is not expanding, such as the ferryboat company described in the Toronto, Hamilton & Buffalo Navigation Company Case,[2] but let us assume that our hypothetical company is not faced with the competition of a bridge, that it started operations fifty years ago with three ferryboats representing a total investment of $1,000,000, and that it can look forward to another fifty years of operation. The company has paid a modest dividend throughout those years, accumulated no surplus to speak of, but has set aside each year an amount for depreciation which with interest now amounts to exactly the amount of the original investment, and—as it is a hypothetical case—let us assume that the ferryboats are all condemned and must be replaced this year, precisely when the engineers who computed the original depreciation accruals predicted they would have to be retired.

The company finds, however, that its $1,000,000 depreciation fund is exactly enough to buy one ferryboat, not three, and that it must have three ships to continue the service. Being a public utility, it is compelled to continue operation. Where is it to get the $2,000,000 additional capital needed to buy three new ships? Neither the income tax people nor the rate-making authorities would have allowed it to charge as an expense in the past any more than just barely enough to cover the original cost of the investment. What has happened then is that the investors who put their money into three ferryboats fifty years ago and who served the public faithfully all those years are now required to invest a further $2,000,000, following which they will have three ferryboats no newer and no better than those they started with. If they want better ships, that will cost more money.

Is it likely that the company can find new investors to put up the $2,000,000 when the original investors have had two-thirds of their investment confiscated? Hardly—the only probable outcome is insolvency and government ownership.

THE same process of piecemeal confiscation is taking place in the telephone industry today—and in other utilities, railroads, and heavy industry in general.[3] For example, telephone equipment which cost $250 a line less than ten years ago costs double that amount today, and when a company is allowed to charge depreciation expense only on $250 it means a confiscation of 50 per cent of its investment even if costs go up no higher than they are at present. Because retirements and replacements are piecemeal, because telephone plant continues to expand, and because superlative management and maintenance have stretched depreciation accruals so that they perform more work than could conservatively have been anticipated, the actual facts of confiscation are hidden in a maze of figures and obscured by group accounting, but the confiscation is there just as truly as in the hypothetical case of the ferryboat company—only working twice as fast, on a 25-year basis instead of on a 50-year one.

That is the situation and—as in the case of the ferryboat company—the problem is where to find the money to replace the present equipment when the shareholders realize that half of their investment has gone down the drain. Undoubtedly, there are some who see bankruptcy and government ownership as a perfectly acceptable and inevitable solution.

APPENDIX

Various economists whose books and testimony have been widely cited by the regulatory bodies frankly admit that their ultimate ideal is government ownership. For my part, I have sufficient faith in the good sense of the majority of the American people to believe that the trend to Socialism will have reached its limits by the end of 1952. I have confidence too that the regulatory authorities will soon perceive that present policies can lead to no other end than government ownership. So, having stated the problem, let us now proceed to the law on the subject.

The Law

THE Supreme Court, in United Railways *v.* West, recognized the existence of the problem when it held that depreciation, like rates of return, should be computed on present fair value,[4] but the decision was not in harmony with usual business accounting methods then, now, nor at any time—at least as far back as the time of Christ when Vitruvius set down as clear a definition of straight-line depreciation accounting based on cost as has ever been written.[5] In any event, the United Railways theory was demolished by Brandeis' dissent in that case, discarded by Hughes in Lindheimer *v.* Illinois Bell, and expressly overruled by Douglas in the Hope Gas Case,[6] so that it would be a waste of time at this late date to challenge the standard accounting practice of depreciation based on cost.

Many authorities hold that that ends the matter—there is no confiscation if depreciation gives back to the investor the same number of dollars that he originally invested. The example of the ferryboats shows that that conclusion simply is not true. Furthermore, as I see it, the Brandeis dissent and the Illinois Bell decision, which today embody the law of the land, by no means close the door—in fact they point the way—to a solution which will provide for replacement of plant and not merely for recuperation of the original cost. The answer is to be found in the *ratio decidendi* of the Brandeis and Hughes opinions.

THE Hope Gas decision gives Lindheimer *v.* Illinois Bell as authority for basing depreciation charges on cost.[7] The Illinois Bell decision in turn defines depreciation, describes the straight-line accounting method of computing it, and states the purpose of depreciation accounting; namely, "to include in the operating expenses . . . an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered."[8] Here the court refers us to Knoxville *v.* Knoxville Water Co. 212 US at pages 13 and 14 from which I quote:

> Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs, but for making good the depreciation and replacing the parts of the property when they come to the end of their life. The company is not bound to see its property gradually waste, without making provision out of earnings for its replacement. It is entitled to see that from earnings the value of the property invested is kept unimpaired, so that, at the end of any given term of years, the original investment remains as it was at the beginning. It is not only the right of the company to make such a provision, but it is its duty to its bond and stockholders, and, in the case of a public service corporation, at least, its plain duty to the public. If a different course were pursued the only method of providing for replacement of property which has ceased to be useful would be the investment of new capital and the issue of new bonds or stocks. This course would lead to a constantly increasing variance between present value and bond and stock capitalization—a tendency which would inevitably lead to disaster either to the stockholders or to the public, or both.[9]

GOING back to the Hope Case, we read that: "By such a procedure (depreciation based on cost) the utility is made whole and the integrity of its

investment maintained." For authority, the decision refers us to the Brandeis dissent in United Railways *v.* West for "an extended analysis of the problem,"[10] and, in that analysis, Brandeis states that the primary purpose of the depreciation charge is to "preserve the integrity of the investment."[11] In support of that point, Brandeis cites the very same pages 13 and 14 of the Knoxville Water Case which I have just quoted.

That definition of the primary *purpose* of public utility depreciation accounting —to provide for replacements—is then still the law of the land, nor could it be otherwise. The accounting *method* used to achieve this purpose is to figure depreciation on cost which in theory returns to the investor the dollar amount of his original investment; in Illinois Bell and Hope Gas, the court found that this was all that was needed *in those particular cases*. The court did not stultify itself by holding that recuperation of the dollar amount originally invested is the *purpose* of depreciation accounting, for it is obvious that in a continuing utility enterprise the investors never do get their money back.[12] All they expect is that the integrity of their investment be maintained—that they end up with three ferryboats and not just one—and that is what the law provides. In this connection, let me cite Justice Hughes in the Minnesota Rate Cases:

> The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law.[13]

THE Brooks-Scanlon decision, in which Brandeis joined, reiterated that position: "It is the property and not the cost of it that is protected by the Fifth Amendment."[14] Later, five years after the Hope Gas decision, the same doctrine was upheld in TVA *v.* Powelson and in the Toronto, Hamilton & Buffalo Case with specific page citations to the Minnesota and Brooks-Scanlon cases.[15]

Why then, if it is the property and not the cost which is protected by the Constitution, did the Hope Case and the Hughes and Brandeis opinions cited in that case, uphold the accounting practice of basing depreciation on cost? Because, as Brandeis says in his United Railways dissent, "the only expense of plant retirement which is capable of reasonable ascertainment (is) the known cost less the estimated salvage value," and he adds:

> . . . The most that a continuing business like a street railway may expect is that, at the end of the service life, it shall be reimbursed with the then value of the original investment or with funds sufficient to replace the plant . . . (However), there is no basis for assuming that either the value of the original investment or the replacement cost will, at the end of the service life, equal or approximate the present value . . . as to this, even the economist can know nothing, save how the general price level has heretofore fluctuated from year to year; and that periods of rising prices have ever been followed by periods of falling prices.[16]

And Justice Stone who agrees completely with Justice Brandeis in that dissent, adds:

> . . . the function of a depreciation fund for rate-making purposes must be taken to be the establishment of a fund for the replacement of plant rather than the restoration of cost or value of the original plant investment.

JUSTICE Stone points out that the universal practice of accountants is to base depreciation on cost, and that experience has shown that cost "has proven to be the most trustworthy guide," adding "I think that we should be guided by that experience and practice in the absence of proof of any special circumstances showing that they are inapplicable to the particular situation."[17]

So there we have a complete expression of the law of the land on public utility depreciation, as enunciated by Hughes, Brandeis, and Stone and con-

firmed by the Hope Gas and later decisions; namely, that a utility company is entitled to accumulate funds sufficient to replace its plant at the end of its service life, and that the only reasons cost is used as the basis of depreciation accruals is because that method has worked fairly well in the past and because original cost is known and ultimate replacement cost is not.

Manifestly, the burden is on the utility companies to show that today there are special circumstances such as Justice Stone referred to which warrant a new approach to the problem of utility depreciation, and—having stated the problem and the law—let us now pass on to the solution.

The Solution

THE simplest, most sensible solution I have seen is not of my making. It was proposed by the Southern Bell Telephone & Telegraph Company in a Georgia rate case and later in Alabama, Florida, Tennessee, and Louisiana.

Briefly, the proposal was to continue basing depreciation accruals on cost, but supplementing them by charging as an expense the difference between the original cost of the property retired in a given year and the average replacement cost of that property in that year. The commissions turned down this proposal on the grounds that it was not sanctioned by good accounting principles, nor by the FCC, nor by the Bureau of Internal Revenue, and because the commissions considered that the company should provide the capital requirements of the business, not the ratepayers, and that present subscribers should not be asked to pay for replacements for the benefit of future subscribers.[18]

In view of those decisions, I should like to advance an alternative solution that should be more acceptable, at least from the viewpoint of theoretical economics, which nowadays seems to take precedence over practical finance or constitutional law.

THE problem of inflation, as we all know, is merely one of currency depreciation and can be approached from that viewpoint. In other countries they have had the same problem for years, but in much more aggravated form. For example, our Shanghai company got 10 rate increases in a 12-month period, and I recall one cable we received from the manager that year:

> RECEIVED RATE INCREASE TUESDAY. STRONGLY PROTESTED INADEQUACY AND RECEIVED SECOND RATE INCREASE FRIDAY.

By the time the government took us over, residence rates were 300 times the pre-Communist level. Coin boxes were substituted by wooden crates to hold the paper money and the crates had to be dumped twice daily to get the money to the bank before it depreciated.

When currency depreciation reaches those extremes, the accountants, public service commissioners, and judges have to be pretty well set in their ways to ignore it. When a telephone accountant finds that the annual depreciation charge will just about buy one telephone, he knows that something has to be done—and quickly. In each country where the problem has arisen in acute form—and that includes most of the world—it has been met, in some cases by a single revaluation of plant, in others by a continuing series of revaluations, in other cases by accruals to a foreign exchange or currency depreciation reserve or by means of secondary books kept on a gold basis.

IN the United States, with only two-fold inflation—50 per cent confiscation—the problem could be met by say monthly accruals to a currency depreciation reserve to take care of the difference between the original cost of property and the estimated current cost—not just of the plant retired—as in the Southern Bell proposal—but based on the entire plant, the same as the accruals for depreciation. For reasons of policy, the reserve should probably be labeled "Reserve for Retirements and Replacements," rather than for "Currency De-

preciation," and certainly it should not be added to the regular depreciation reserve, or we might later find it deducted from the book cost of plant to arrive at a net rate base.[19]

The mechanics of the plan should not be too difficult to work out. At the end of each month, an accrual would be made to this new reserve representing the difference between the accruals to depreciation figured on cost and what those accruals would be if figured on present fair value. The difference would be computed on the basis of material prices, labor costs, material-labor ratios, and taxes, in precisely the same way as current cost studies are now made in many rate cases. In some of the larger companies, these indices are already kept up to date for rate purposes and a system could be worked out initially for the smaller companies by one of the independent experts in that field and kept up to date with little trouble.

UNDER FCC, FPC, and ICC rules, the computation of depreciation rates must be based on forecasts of future net salvage value and, among other factors: "obsolescence, changes in the art, changes in demand and requirements of the public authorities." [20] If we can predict the requirements of the public authorities, and have our predictions accepted by the Bureau of Internal Revenue, we should certainly not be stumped by any difficulties in these current cost computations.[21]

The reserve could be started by making an actuarial reserve requirement study of the present reserve for depreciation. Any excess in that reserve—and a well-managed utility should have an excess—could be transferred to the new currency depreciation reserve to the extent needed on the basis of present costs, and the balance credited to the company's earned surplus. This procedure would quite properly reduce the depreciation deduction where commissions insist on using a net book cost rate base, and the excess in the depreciation reserve unquestionably belongs to the company as was held by the Supreme Court in the New York Telephone Company Case and other cases.[22]

The question then is whether a court —the Supreme Court— would recognize the propriety of a currency depreciation reserve, by whatever name it might be called.

The Brandeis, Hughes, and Stone opinions which I have quoted indicate that those justices if they were alive today would certainly admit the validity of such a reserve provided that the company involved were able to demonstrate that present circumstances are such that original cost no longer represents a trustworthy guide to probable replacement cost—that a new plateau of prices has definitely been established on the basis of higher wages and higher taxes which no one can reasonably expect to revert to former levels.[23] By the same token, the present court cannot without stultification accept the Brandeis and Hughes opinions as authority in the Hope Gas and later cases, and reject the *ratio decidendi* of those opinions, so I would say that in a proper case, properly presented, we should be able to rely on the continued application of the Minnesota and Brooks-Scanlon doctrine—"it is the property and not the cost of it that is protected by the Fifth Amendment."

IN support of the currency depreciation approach to the problem, I might point out that in the Lindheimer *v.* Illinois Bell Case, the evidence before the court carried down only to the end of 1932, in the United Railways Case down to 1929, both prior to devaluation of the dollar.

When the United States government altered the gold equivalent of the dollar, in effect it created a new monetary unit. Suppose that it had at the same time changed the name of the currency, as so many other countries have done in the course of devaluation, does anyone believe that if the Illinois or United Railways Case had come up under such circumstances, Hughes, Brandeis, or Stone would have held that there was no confiscation provided the company were allowed to recuperate say one peso or one

shilling for each dollar invested? Manifestly not. The court would certainly have held that the circumstances were such that the recuperation of original cost—pesos for dollars—would no longer give the investor, to quote Justice Brandeis, "funds sufficient to replace the plant." But the cases arose too soon, the name attached to our currency was not changed, there was no Food and Drug Administration requirement that the label on the dollar show its adulterated content, and there was no evidence in 1929 or 1932 that the change in equipment prices was anything more than a transient and recurrent fluctuation, such as had occurred many times in the past.

With the devaluation of the dollar, however, and other still more serious inflationary influences, currency depreciation would seem to be the proper angle from which to attack the problem, and there is basically no reason why regulatory bodies and the Bureau of Internal Revenue should accept LIFO methods, based on price indexes, for the consumption of inventory, and reject similar methods for the consumption of equipment.[24]

Conclusion

IN closing, I should say something of the magnitude of the problem which I have been discussing.

In the case of the electric utilities it would seem conservative to say that the adjustment of depreciation charges to reflect present replacement costs would increase that expense by at least 60 per cent, reducing 1951 net income by close to $300,000,000 or about 35 per cent. On the balance sheet side, even assuming that prices rise no higher than at present, the shortage in the depreciation reserve would be at least two and a half billion dollars, which would be enough to wipe out completely the present corporate surplus and about a sixth of the present par value of the common stock.[25]

The telephone industry, and particularly the Bell system, has installed so large a proportion of the dollar value of its plant since 1945, at relatively high prices, that a 30 per cent adjustment would appear to be sufficient, and this would cut net income by about $115,000,000 or say 30 per cent. On the balance sheet side, the depreciation reserves would be short about a billion dollars, which would be equivalent to eliminating the present surplus and wiping out nearly a fifth of the present par value of the common stock.[26]

To a greater or lesser degree, the same situation is true of other public utilities and heavy industry in general, and unless the commissions and the Bureau of Internal Revenue are willing to take a new look at depreciation accounting methods—and I mean raise rates and reduce taxes—most of our public utility companies will soon find that they have only one ferryboat left instead of three, and that receivership or government ownership is waiting for them at the next bend in the river.

Footnotes

[1] The views herein expressed are those of the author and do not purport to represent the position of IT&T.

[2] United States *v.* Toronto, Hamilton & Buffalo Nav. Co. (1949), 338 US 396, 94 L ed 195.

[3] In *Changing Concepts of Business Income*, Macmillan, 1952, pages 82, 83, a committee of the American Institute of Accountants reported: "The light industries, if they employ LIFO inventory accounting, are adversely affected only in respect of physical capital, and to a very limited extent. . . . The heavy industries, which employ large amounts of consumable capital assets, that have a fairly long life, suffer the heavy burden; the extent is greater according as more of the exhaustion goes through depreciation accounts rather than maintenance accounts, and according to the extent that there are offsets in the form of extraordinary amortization of emergency facilities or 'accelerated' depreciation. Existing differences in methods are strikingly illustrated by the fact that in the case of the railroads 70 per cent or more of exhaustion charges go through maintenance on the basis of current costs, whereas in the case of electric utilities 70 per cent go through depreciation accounts on the basis of costs of past years."

[4] United R. & Electric Co. of Baltimore *v.*

West (1930) 280 US 234, 254, PUR1930A 225, 74 L ed 390, 411.

[5] Vitruvius, a Roman architect of note, who lived about the beginning of the Christian era, wrote a treatise on architecture from which the following is an extract: "No walls made of rubble and finished with delicate beauty—no such walls can escape ruin as time goes on. Hence, when arbitrators are chosen to set a valuation on party walls, they do not value them at what they cost to build, but look up the written contract in each case and then, after deducting from the cost one-eightieth for each year that the wall has been standing, decide that the remainder is the sum to be paid. They thus in effect pronounce that such walls cannot last more than eighty years." (From Lyndon Lamarr, *Rate Making for Public Utilities*, McGraw-Hill, New York, 1923, page 51, quoting from Drexel Institute Monograph, by C. J. Tilden, February 16, 1916.)

[6] United Rys. *op. cit.* 280 US 234, 255-288, 74 L ed 390, 411-429; Lindheimer *v.* Illinois Bell Teleph. Co. (1934) 292 US 151, 166-8, 3 PUR NS 337, 78 L ed 1182, 1192-3; Federal Power Commission *v.* Hope Nat. Gas Co. (1944) 320 US 591, 606-7, 51 PUR NS 193, 88 L ed 333, 347.

[7] *Op. cit.* 320 US 591, 606, 88 L ed 333, 347.

[8] *Op. cit.* 292 US 151, 167 note 20, 78 L ed 1182, 1193.

[9] City of Knoxville *v.* Knoxville Water Co. (1909) 212 US 1, 13, 14, 53 L ed 371, 380.

[10] *Op. cit.* 320 US 591, 606 note 11, 88 L ed 333, 347.

[11] *Op. cit.* 280 US 234, 264, 74 L ed 390, 416. According to Brandeis, depreciation accounting is introduced "to serve three purposes. It preserves the integrity of the investment. . . . It serves to distribute equitably throughout the several years of service life . . . the known cost less the estimated salvage value. And it enables those interested . . . to ascertain, as nearly as possible, the actual financial results of the years' operations."

[12] Professor William Paton, dean of American university accounting authorities, writes that one of the two "fundamental concepts" of accounting is that of "continuity of operation," the other being that of monetary stability. George May adds a third postulate to these two, that business gain is to be recognized at the moment of realization. See Percival F. Brundage, *Harvard Business Review*, July, 1951, pages 10, 11.

[13] Simpson *v.* Shepherd (1913) 230 US 352, 454, 57 L ed 1511, 1564.

[14] Brooks-Scanlon Corp. *v.* United States (1924) 265 US 106, 123, 68 L ed 934, 941.

[15] TVA *v.* Powelson (1943) 319 US 266, 285, 87 L ed 1390, 1403; U.S. *v.* Toronto, Hamilton & Buffalo Nav. Co. (1949) 338 US 396, 403 note 4, 94 L ed 195, 201.

[16] *Op. cit.* 280 US 2324, 262 note 12, 264, 278 note 49, 74 L ed 390, 415, 416, 424.

[17] *Op. cit.* 280 US 234, 289, 290, 74 L ed 390, 429, 430.

[18] *Re* Southern Bell Teleph. & Teleg. Co. (Ga.) Docket 195-U, File 19315, November 1, 1951, 91 PUR NS 97; *Re* Southern Bell Teleph. & Teleg. Co. (Ala.) Docket 12920, January 25, 1952, 92 PUR NS 97; and *Re* Southern Bell Teleph. & Teleg. Co. (Fla.) 92 PUR NS 335. The Alabama commission pointed out that for the company to recuperate its alleged retirement loss of $479,105, it would have to increase rates by $1,055,000, thanks to the tax burden. This brings up one of the most serious aspects of rate revision, but the author is optimistic enough to believe that a solution of that problem is by no means impossible—after November.

[19] This may seem fantastic, but one economics professor states that if depreciation is computed at current levels and the "gross asset value is kept at original cost" a company's accounts might "show some assets with negative book values" (E. Cary Brown, "Depreciation Adjustments for Price Changes," Harvard University 1952, pp. 98-9), and later states that "the excess of replacement-cost over historic-cost depreciation" would logically be considered a capital gain and taxed accordingly at the time of retirement! (*Ibid.* page 109.)

[20] FCC Uniform System of Accounts, § 31-01-3; FPC *idem*, Definitions 13.

[21] "We think that in the case of railways and regulated utilities, provisions for exhaustion of property computed on the basis of current price levels should be made mandatory, as a matter both of good accounting and of sound economic policy. . . . We find it difficult to understand why an accountant who claims, and is presumed, to be competent to pass upon the fairness of a purely subjective computation of a charge for accelerated depreciation or of the application of LIFO accounting on the basis of price indexes should not be, or be expected to become, competent to pass also on the fairness of an application of a price index to a charge for exhaustion." George O. May and Oswald W. Knauth, in *Changing Concepts of Business Income*, Macmillan, 1952, pages 135-138, prepared by committee of American Institute of Accountants.

[22] Board of Public Utility Comnrs. *v.* New York Teleph. Co. (1925) 271 US 23, 30-32, 70 L ed 808, 812, 813; Pacific Teleph. & Teleg. Co. *v.* Whitcomb (1926) PUR1926D 815, 12 F2d 279, 283-4, affd. 276 US 97, 72 L ed 483.

[23] "Needless to say, the future course of this inflation will be unknown until it has ceased to be the future. I am ready to assume, however, that we have not yet reached the top of the hill; that we are not quite sure whether there will be any well-defined top; and that an ultimate return to the price levels prevailing before the last war cannot be predicted with confidence." James C. Bonbright, *Land Economics*, February, 1951, page 16.

"We in the United States were blessed for many years with a monetary unit having a relatively stable value or purchasing power in

that short-term fluctuations normally tended to average out over the business cycle. We therefore customarily assumed that the dollar might be regarded as a uniform standard of measurement of wealth for the purpose, among others, of distinguishing between income and capital and of ascertaining the extent to which any particular capital asset has been exhausted. Today, however, it is abundantly clear that the dollar cannot be so regarded. Since 1939 the purchasing power of the dollar has been reduced by approximately one-half; there is grave doubt whether its downward progress will be checked here; and certainly there appears to be little likelihood that it will regain its prewar value." Arthur H. Dean, 65 *Harvard Law Review* 8, June, 1952, page 1347.

"The prospect that the general price level will continue to be substantially higher, again presents for consideration the inherent economic validity of provision for depreciation on a basis adjusted for the change in the purchasing power of money." J. Rhoads Foster and Bernard S. Rodey, Jr., PUBLIC UTILITIES FORTNIGHTLY, February 15, 1951, Vol. XLVII, No. 4, pages 232-3.

[24] "It is difficult to see how acceptance of LIFO as now applied can long be combined with rejection of the current price level as a basis of charges for property exhaustion." *Changing Concepts of Business Income, op. cit.* page 60.

[25] This is on the assumption of a 60 per cent increase in depreciation requirements, which seems reasonable; *viz.* The Peoples Gas Light & Coke Co. Docket 38244, Illinois Commerce Commission, 1951, shows a 66.5 per cent difference between depreciation based on original cost and depreciation based on the BLS Consumers' Price Index as of June 30, 1951. That index shows far less depreciation of the dollar than do construction indexes or special indexes based on public utility plant. The National City Bank Monthly News Letter, August, 1949, page 61, estimates that 1948 depreciation accruals of all industries would have to be increased by $4.4 billion to allow for the excess of replacement cost over original cost, which means a 71 per cent increase over the $6.2 billion depreciation estimated for that year in "The Economic Report of the President," January, 1952, page 203. J. Gaston Frank in "Effects of Depreciation Policy," National Industrial Conference Board, New York, 1950, page 16, estimates the increase at $3.8 billion for 1948, or 61 per cent. Professor E. Cary Brown in "Depreciation Adjustments for Price Changes," Graduate School of Business Administration, Harvard University, 1952, pages 28-34, uses a 50 per cent increase in his computations covering all industries other than utilities, based on 1951 estimates. Considering that utilities have a relatively long-lived plant and that 1952 prices are considerably higher than in 1948 or 1951, an assumed 60 per cent increase in depreciation requirements for utility plant seems quite conservative.

The figures used are based on the FPC "Statistics of Electric Utilities in the U.S." for 1951 except for surplus and common stock figures which are from the December 31, 1950, report.

[26] These percentages—30 per cent for the telephone industry and 60 per cent for the electric—are hypothetical. The actual percentages can only be determined by each individual company, and group percentages have little significance other than to indicate the magnitude of the problem. In the case of Southern Bell Teleph. & Teleg. Co. it is estimated that accruals based on current costs would be 26 per cent higher than on original cost, but the industry figure may be considerably higher, as the postwar increase in the dollar plant investment in that particular company has been much higher than in the industry as a whole.

The figures used are based on the FCC "Statistics of the Telephone Industry" for the twelve months ended December 31, 1951, except for the surplus and common stock figures which are estimated on the basis of the December 31, 1949, report.

Public Utility Depreciation

By CHARLES W. SMITH*

ELEVEN years ago this month I addressed this section at Indianapolis on the subject of depreciation. I return to that subject today with the same perseverance with which a murderer returns to the scene of his crime.

Eleven years ago gas and electric utilities had just inaugurated a new method of accounting for the consumption of plant; namely, depreciation accounting. There was considerable doubt and uncertainty as to how the new requirements would work, some fear in the industry that the results would not be good. In fact, in the opinion of many utilities, the depreciation provisions of the then new System of Accounts were exceeded in their undesirability only by the require-

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ment that the accounts be stated on an original cost basis.

Eleven years ago I strongly supported the straight-line method of depreciation accounting. I urged before this group, with some temerity, that the annual provision for depreciation, that is depreciation expense, be harmonized with the deduction of accrued depreciation in the computation of the rate base by the deduction of the depreciation reserve. You will remember that that was before the Supreme Court decision in the Hope Case.

What has the experience of these intervening eleven years shown? It has shown that depreciation accounting can work, in fact has worked well. Utilities on the whole have done a good job in applying depreciation accounting principles.

In 1940 the depreciation reserves of the class A and class B electric utilities amounted to $1,912,000,000. At the end of 1951 the reserves amounted to $4,734,000,000. In 1940 the reserves were about 13 per cent of plant, whereas at the end of 1951 they amounted to about 20 per cent, although in the meantime plant increased about 60 per cent. I am sure all of you know the important part played by improved depreciation practices in respect to the financing of these large plant additions.

The method of depreciation accounting which has come into the ascendancy in this period is the straight-line method. There are some electric utilities which use interest methods but their number is not great. The chief electric utilities employing an interest method are located in this area. Eleven years ago they were in advance of the depreciation procession—their depreciation reserves exceeded the reserves of electric utilities in general. That is not true today. Some of the largest electric utilities employing an interest method have descended from a position of much above the average to a position of below the average. I suggest that every electric utility using an interest method —I know of very few gas utilities using that method—re-examine its practices to see if it should not get in line with most of the other members of the industry.

Consistent treatment of depreciation expense and accrued depreciation has been obtained in rate proceedings. Overwhelmingly, where the straight-line method is used, the depreciation reserve is now deducted in arriving at the rate base.

In looking over my notes of eleven years ago I found one argument against depreciation which at the time received great emphasis but which I have not heard mentioned for several years. I believe you have forgotten it too. It was the argument of the "vanishing rate base." It was seriously contended that the deduction of depreciation reserve in the computation of the rate base would result in a diminishing base until the base would almost disappear entirely. The net plant of the class A and class B electric utilities in 1940 amounted to about $12.5 billion, whereas at the end of 1951 it amounted to about $18.5. Thus it appears the theory of the vanishing rate base itself has vanished while the rate base, in fact, goes merrily upward.

Accordingly, it appears that great progress has been made in the field of depreciation since I spoke to you last. It would seem, on the surface at least, that many, if not most, of our depreciation problems had been substantially solved.

But depreciation is a subject which will not stay down. Today we have a somewhat growing agitation for a new kind of depreciation. Strangely enough, in view of the history of public utility depreciation practices, the current arguments are aimed not at recording less depreciation expense than is accomplished in the normal or orthodox manner, but a great deal more. It is being seriously argued by some representatives of the utility industry, and perhaps by a few utilities themselves, although I know of only two or three which seriously support the argument, that depreciation should not be based upon cost as provided generally in the Uniform Systems of Accounts but should be based upon the value of utility property.

APPENDIX

I HAVE said on numerous occasions that a utility which does not record adequate depreciation expense is courting disaster. If it is necessary to allow depreciation on a value basis in order to preserve the soundness of the utility industry, then I would be for it, for I would no more relish trying to regulate a sick industry than you would enjoy representing one. After studying the question seriously and long, I am convinced that the fair value method should not be employed.

Now we are not without some experience in this field. My very first work when I became associated with utility regulation was to help write the brief in the United Railways[1] Case in which the company claimed depreciation on a fair value basis. The Supreme Court upheld the company's contention in January, 1930. The Supreme Court decision was never popular with the industry and from the time that decision was handed down until 1944, when it was specifically overruled in the Hope Case,[2] I do not recall having met one single utility representative who favored fair value depreciation. In fact, I have always felt that there was general agreement that the court's action in the Hope Case in this respect was eminently sound. This experience in a different economic era should not readily be dismissed.

The fair value argument is rooted in the proposition that the function of depreciation accounting is to finance replacements. I would be the last person to deny that depreciation does have consequential financial effect, but certainly its function is not to finance replacements. The function of depreciation accounting is to record an actual cost of operation. Plant is purchased in advance of use and when use occurs the cost of the plant is charged *pro tanto* to operations. In other words, it becomes a cost of service, like labor and fuel. If the plant is never replaced that does not excuse the recording of depreciation. If a loss is sustained, in which event depreciation accounting does not aid in financing replacements, depreciation goes on just the same and must be recognized.

PLANT, in a sense, is a deferred charge to operations. Suppose instead of buying plant a utility rented it under a long-term lease. What would be the cost of the annual rent? Obviously the dollar amount paid.

There is no substantial difference between acquiring the use of plant under a long-term lease and buying it outright. In both cases the cost is definite and fixed. In both cases different amounts may have to be paid in the future for the use of new equipment replacing the old. This fact, however, does not change what has already been paid in the one case or agreed to be paid under the lease in the other.

Any item of expense may increase in the future—labor, fuel, supplies. That is no reason why costs presently incurred should be inflated because they may be higher in the future. This, in my opinion, is just as true of plant as of anything else. When the cost is incurred it should be recognized and not before.

Fair value depreciation is based upon the premise that the cost of replacement will be different from the original cost and that sufficient cash to finance the replacement must be derived from the use of the old item. Accepting the theory *arguendo*, this means that an estimate must be made today of the cost of replacing items of plant many years in the future. It is necessary under the theory to estimate the price for decades to come. If a new generating station is purchased today for $50,000,000 and it is estimated that at the end of forty years, in 1992, the cost of replacing it will be $100,000,000, then depreciation must be accrued beginning immediately on $100,000,000. If it is estimated that all the natural gas pipelines built in recent years will have a replacement cost at the time of replacement of 100 per cent or more above original cost, then all such pipeline companies, under the theory, must begin today to accrue depreciation on that estimated replacement cost. It is sheer

[1] United R. & Electric Co. *v.* West (1930) 280 US 234, PUR 1930A 225.

[2] Federal Power Commission *v.* Hope Nat. Gas Co. (1944) 320 US 591, 51 PUR NS 193.

speculation, of course, to guess at what the cost of generators and natural gas pipelines will be in 1992.

I WOULD like to emphasize that the estimated cost of replacement at the time of replacement is the core of the fair value depreciation argument. If the price of generators should increase 100 per cent by 1980 and then decrease to the old level by 1992, no problem in respect to a generator to be replaced in the latter year would be presented, for the level of prices when replacements are not made is of consequence under the theory. It makes little difference to me how high caviar goes if I am not in the mood to eat caviar. It makes little difference how high the price of gas pipelines and generators go to a utility not in the market at the time to purchase them. When we start to predict the cost of replacement of utility property far into the future, we can see how speculative, conjectural, and controversial the results will be.

Another basic assumption of the fair value theory is that price levels will not materially recede. I have yet to meet anyone who would argue for fair value depreciation in a period of declining prices. Many times in the 1920's I heard statements to the effect that prices would not recede. I believed them then. I heard many responsible people say in the 1920's that we were on a new plateau of prices and destined to stay there for many, many years. You probably heard statements of the same tenor. But we know what occurred in the 1930's.

I certainly do not know what the future of prices will be, but I firmly believe there will be price cycles. Certainly there are many signs that prices could change. Wars have always caused sharp increases in prices. After peace has been restored prices have always decreased. An exception relates to World War II during which prices were rigidly controlled, but here the upward trend was merely delayed for prices rose after the war ended and, before normal economic forces had a chance to be effective, we were thrust into another emergency situation.

What the situation will be if full peace is gained I do not know, and I am naïve enough to believe that no one else knows. In this connection the Baltimore *Sun* of September 9th, under a date line Mexico City, September 8th, contained a news item of which the following was the headnote:

> Some of the world's top economists today told governors of the World Bank and International Monetary Fund that inflation in the United States would subside during the coming year.

I say, therefore, that it is dangerous to base important long-term plans on uncertain beliefs as to what the future holds in the way of prices.

I make the foregoing statement because if fair value depreciation is right it must not merely be permissive but must be required. If it is to be required in times of high prices, it must also be required in times of low prices. With our corporation laws being what they are and with bond indenture provisions being what they are, fair value depreciation in times of a decline in prices could cause serious maladjustments. These maladjustments could be so disturbing that I am sure no utility would think of sponsoring value depreciation if it thought prices would not remain high. United Railway & Electric Company's fair value depreciation looked rosy in 1929, but in 1933 it took on an entirely different aspect.

OF course, public utility property is not acquired in low-price periods only. The largest growth of electric and telephone utilities in their history has probably occurred during the last five years, a period of relatively high prices. The property at any one time represents an admixture of properties acquired at high, at low, and at "medium" prices. If we have price changes in the future like we have had in the past—price cycles, in other words—the law of averages ought to even things up pretty well for all practical purposes, even under the value concept.

It is maintained in support of the value

theory of depreciation that mixing dollars of different vintages, as we do in normal accounting procedures, is like mixing apples and oranges. But if this is a serious thing, how much more serious is the mixing of different plant items with different technological characteristics and calling them all one? Think how much more serious it is to assume that a 1915 generating plant, a 1925 generating plant, and a 1952 generating plant are the same, which is the assumption inherent in the use of the value method.

By trending the cost of an old generating station to the price level prevailing in 1952 we get, in effect, the estimated cost of a new plant. What electric utility would consider today buying a 1915 generating plant? It would no more do so than it would buy a Model T Ford for the official use of its president. Such things are just not done.

THE value of property for purposes of stating depreciation on a value basis is usually arrived at by the use of index numbers. This method is inadequate, inaccurate, misleading, and unscientific. The method could not result in determining present value, much less value at the time of replacement, except by sheerest coincidence. General price index numbers do not represent replacement cost of specific items. The general price level is composed of many averages, some up and some down. Everyone knows, for instance, that the price of television sets has decreased in the midst of a general rise in prices.

By trending the cost of 1915 electric generating stations to the price level prevailing in 1952 we get a ridiculous result. The reason is technological improvement. The index number assumes technological stagnation, whereas the outstanding accomplishment of our industrial machine has been technological progress. This technological improvement is ignored in the trending process—the process assumes that there must be sufficient "depreciation funds" when the 1915 machine wears out to buy a new machine with all of the technological advantages thereof. This is far worse than mixing dollars of different vintage which is reflected in the cost basis. Old items of equipment are frequently as different from new as night is different from day.

It is a well-known fact that the cost of a kilowatt of capacity of electric generating stations has not paralleled the change in the general price level. We are building a different kind of station today, less masonry, less iron and steel, and much bigger and more efficient units. Only recently it was announced in the press that a new metal had been developed, 16 pounds of which would replace 40 pounds of old metal in generating stations.

ACCORDING to statistics of the Federal Power Commission the electric steam station fuel rate in 1937 was 1.44 pounds of coal per kilowatt hour, while in 1951 it was 1.14 pounds, with some stations today requiring less than a pound of coal for a kilowatt hour of production. The difference between the 1937 and the 1951 fuel rate would be about $225,000,000 annually on the basis of 1951 production. Capitalized at 6 per cent this difference becomes $3.7 billion. No trending process which does not take this fact into consideration is worth noting.

Technological improvements are constantly going on. The President's Materials Policy Commission stated in its recent report that we may expect a further increase of 25 per cent in fuel efficiency in the next twenty-five years.

Anyone who has had the slightest knowledge of the telephone industry knows of the great technological improvements which have been brought about therein. I am informed that by reason of such improvements between 1943 and 1950 the average cost of toll line to American Telephone and Telegraph Company was reduced from $109 to $59 a circuit mile (talking circuit mile, due largely to cable carrier systems and coaxial cable.

Accordingly, mixing such unlike things as old and new plant items and calling them the same is inaccurate and thoroughly unscientific.

A serious error in the value depreciа-

tion process results in a double charge against consumers. Consumers are charged with the cost of operating the old equipment—old generating stations, old steam locomotives, and old cable—while, at the same time, they are required to pay the assumed depreciation cost on the new, better, and more efficient equipment which is not yet rendering service. In other words, they are paying $225,000,000 a year fuel cost which they would not incur if new equipment now available were in operation.

Speaking of equity, this hardly seems to be fair.

THIS section of my paper could be expanded at great length. Let me limit it by reiterating that the valuation process ignores one of the greatest events of our industrial experience—technological improvement. The method assumes technological stagnation. It must be rejected on this ground alone.

It is sometimes argued that only that part of the investment in plant which is represented by common equity should be depreciated on a value basis. This argument stems from the fact that debt securities and preferred stock have fixed redemption prices.

This departs from the theory that the function of depreciation is to finance replacements. Moreover, the past cost of plant is just as fixed and definite as the redemption price of bonds. In a nutshell the method is merely an escalator clause designed to increase the common stock equity through excessive depreciation accruals so as to maintain the purchasing power of the common stock. It is no more and no less than this. While I can understand why anyone would seek protection against the harmful effects of inflation, I do not believe that doctoring the depreciation account is by any means a sound procedure.

It is said that if additional capital must be raised to finance replacements costing more than the items replaced, capital erosion occurs. Stated another way, when additional outside capital is required to maintain the same plant capacity, capital erosion results. It is then maintained that consumers must stand the brunt of this capital erosion. And I maintain that they will do so, but at the proper time.

PUBLIC utilities under modern regulation have a real inflation hedge as far as depreciation goes. When the money is spent for a new plant, whether in high- or low-price periods, depreciation is calculated on that cost. It is not necessary to theorize. The expense is allowed when the cost is incurred. Competitive enterprises, I might note, do not have this protection.

When the new plant is acquired and renders the improved service, customers in the utility field who use the service must pay therefor. This is fair alike to the consumers and to the utility. If additional capital is needed to finance the new plant, that new capital will be protected both in the allowance for depreciation and in return thereon. This is a practical and equitable answer to the value depreciation question in the utility field, in my opinion. It avoids conjecture as to future prices, it allows properly for technological improvement as well as for future economies of operation. It stays on the hard ground of fact and does not bear us up in the clouds.

OTHER things being equal, the dollars of return on original capital will not be reduced if additional capital is necessary to finance replacements. True, such dollars will not buy as much as in noninflationary times. This, however, is true of all dollars. It is especially true of bondholders' dollars. But when we leave the objective test of the established market price and attempt to compute the compensation for capital by other means, such as increasing or decreasing depreciation experience, we depart from objective standards and substitute subjective standards. I regret as much as anyone can that the dollars today have impaired purchasing power. I submit, however, that the remedy for this unwholesome condition is not in the hands of regulatory commissions, but rather the problem, if it is to be solved by governmental authority, must be attacked at its source.

APPENDIX

ALL of the Uniform Systems of Accounts for public utilities require adherence to the cost basis. Our recent experience with depreciation on the cost basis has been salutary. We must not allow ourselves to be stampeded in adopting a novel scheme because of spot conditions in which we live. We should not assume that the conditions in which we live today are permanent in view of the history of prices. As individuals we are often prone to consider conditions of today as relatively lasting. In times of inflation we look for more inflation; in times of depression we are pessimistic as to recovery. Important long-range decisions made under the stress of great inflation or great depression may haunt us in more normal times. Present world political conditions which we hope, and expect, will not be permanent, should not be made the occasion for drastic experiment without more and conclusive proof of a high degree of undesired permanency. In other words, I advise caution in this area. From my conversations with utility people I feel that they are in fact proceeding very cautiously in this matter.

IN conclusion, the record shows that utilities have made great strides in respect to depreciation accounting during the last eleven years. There is room for improvement as to certain of them and steps are being quietly taken to bring the lagging companies into line with good practice. I do not believe we should rest on our laurels, but I am sincerely of the opinion that we should continue on the depreciation course which was charted several years ago and not at this time, under the stress of economic conditions now prevailing, seek to steer a new uncharted course which, for all we know, may lead us in circles.

Comments on the Regulatory Lag

By WILLIAM A. DOUGHERTY*

FOR most of us the word "lag" became a part of our vocabulary in the carefree days of childhood when it meant the act of tossing or shooting the taw to the lag line to determine who got the first shot in a game of marbles. As we use the word today in discussing regulatory lag there is no carefree significance. The situation is fraught with care. Webster defines "lag" as the falling behind of one phenomenon with respect to some other phenomenon to which it is closely related. The phenomenon of adequate rate increases certainly has fallen behind the phenomenon of increasing costs.

Discussion of the existence of the lag in bringing rates up to costs has been extensive. But, as Mark Twain said about the weather, nothing has been done about it; that is, nothing adequate to meet the needs of the situation. Lag is nondiscriminatory. It affects all public service companies whose rates can be increased only by compliance with statutory standards. The extent of the lag depends upon many things. A brief review of these hurdles should aid in pointing a way to a remedy. The only excuse for this panel discussion is the hope of finding a solution that will give to the utility promptly the revenues needed, and at the same time protect the consumer against unjustified increases.

Statutory Suspension Provisions

WHILE the fact of the lag is universal, the length varies. Once upon a time increased rates could be put into effect under bond without any delay. Kentucky was the last state to permit this practice, and the Kentucky statute, amended last March, now provides for suspension for a maximum of five months beyond the proposed effective date (§ 278.190 Kentucky Revised Statutes).

The suspension periods vary from the three months provided under the Fed-

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eral Communications Act (47 USC, § 204) to as long as ten months (Illinois Public Utilities Act, § 36). In some states a single suspension period is provided for, and in others it is broken into two parts.[1] The Natural Gas Act has a suspension period of five months (§ 4 (e); 15 USC, § 717c); the Interstate Commerce Act, seven months (49 USC, § 15(7).

Statutes Requiring Prior Approval

In a few states the utility has no right to place in effect increased rates except by order of the regulatory authority, either by way of a temporary or emergency increase or by final decision. Obtaining relief depends solely upon the speed with which the commission will act. California is in this category (California Public Utilities Code, 1951, § 454).

In Ohio, a home-rule state, initial rate regulation of gas and electric rates is in the municipality, with an appeal to the public utility commission. In the absence of agreement with the local authorities, increased rates cannot be made effective until ordered by the commission. This also is true as to telephone rates, over which the commission has original jurisdiction (Ohio Code, § 614-20; 614-45; 614-46).

Instances of Regulatory Lag

Within this statutory framework, what has been the experience of utilities in this matter of lag? A few examples will demonstrate the financial harm that has resulted from the delays that still are besetting us.

The telephone industry probably has been plagued with regulatory lag as consistently as any of the public service institutions. The record of certain subsidiaries of General Telephone Corporation is illustrative of the inability to increase revenues rapidly enough to offset increased costs. Its California subsidiary, Associated Telephone Company, Ltd., experienced the usual rapid increase in costs following the close of World War II.

Application was filed with the California commission for an increase in May, 1949, and in August it was necessary to amend the application, asking for an added amount. The commission granted interim relief in October, 1949. Due to the fact that the return on average invested capital was decreasing monthly, the company further amended its application in December, 1949, and February, 1950. The final order entered in May, 1950, one year after the original application was filed, granted increased rates which were stated to produce a 5.9 per cent rate of return for 1950 on the basis of a full year's operation.

By August, 1950, it was apparent that the increases granted were far from equaling the mounting costs, and a new application was filed asking for further rate increases, which was amended in February, 1951. In June, 1951, an increase was granted on this application which the commission stated would produce a return of 6.1 per cent for the twelve months following the decision. At no time was the estimated return earned, and during 1950 and 1951 the return on invested capital was less than 5 per cent.

A third application was filed in January, 1952, and an order entered in May granting certain increases effective June 1, 1952. The time factors in this record show: an interim increase in five months, a final increase in twelve months; a second final increase in ten months; a third final increase in five months. This improved time schedule shows that the California commission was cognizant of the company's plight and was doing what it could under regulatory requirements to give relief, yet the return on invested capital never reached 5 per cent until June, 1952.

These three proceedings illustrate the ineffectiveness of a regulatory

[1] Thus, in Pennsylvania the code provisions provide for an initial suspension period of six months, and for a further period, at the commission's discretion, not to exceed three months. Schedules must be filed sixty days before the effective date (Purdons Penna. Statutes Annotated, Title 66, § 1148).

process under which the normal methods of investigation and hearing impede the best efforts of a utility to keep its return from dipping to a noncompensatory level. Notwithstanding the continuing endeavors of the company, operating costs increased more rapidly than were offset by the relief granted by the California commission.

In the state of Illinois suspension is permitted for an initial period of 120 days beyond the effective date, with a further discretionary period of six months (Illinois Public Utilities Act, § 36). General Telephone Company of Illinois filed for rate increases in January, 1949, which were suspended through the two permissible periods. A decision was made granting an increase in November, 1949, which was expected to produce a 5.4 per cent rate of return. At no time was this return realized, and in September, 1950, another application was filed and the proposed rates suspended for the two successive periods. Decision was rendered in August, 1951, granting an increase that was stated would produce a 6 per cent rate of return. The actual result was a return under 4½ per cent, and a third application was filed in May, 1952, for a further increase. This case illustrates the unfairness of enforcing second suspensions merely because the case has not been decided. The record over these years demonstrates that the second suspension period should not have been enforced, as the decisions of the commission clearly indicated an inadequate return during all of the period involved. It exceeded 5 per cent in only eight of the forty-two months from January, 1949, through June, 1952.

Donald C. Power, a member of the council of this section, who now is president of General Telephone Corporation, has made available the month-by-month records of the rate of return on average capital for the two companies mentioned and for a third subsidiary, General Telephone Company of Michigan. Those data are reproduced in mimeographed form and are available for distribution at this session.

Lack of statutory authority to collect increased rates under obligation to refund frequently results in the acceptance of less-than-justified increases in order to obtain badly needed revenues. An example is the recent acceptance by the Ohio Bell Telephone Company of an increase of $16,750,000 in a proceeding before the Ohio commission, in which $23,100,000 was sought. The return expected is 4.94 per cent. The company in accepting the compromise announced that the delays involved in carrying the case to a conclusion influenced the company to accept less than it was entitled to have.

Lest you think that only telephone companies suffer from lag, may I cite examples from the gas and electric utilities?

Subsidiaries of the Columbia Gas System in the Appalachian area are subject to the regulatory authorities of seven states and the Federal Power Commission. Increased costs of purchased gas and labor alone in 1952 will be $10,000,000 more than in 1951. To offset this increased cost, rate increases of approximately $2,500,000 became effective in June, 1952, and the system now has pending rate increases for about $15,000,000, of which $5,600,000 are being collected under bond. In order to educate its stockholders about the lag, the Columbia management prepared and sent out last July a booklet entitled "Why the Lag?" Jacob Harvin, counsel for Columbia, has furnished a supply of this booklet which is available for those wishing it. In plain language the problem is described and the serious financial results stated.

In Pennsylvania the practice formerly was to invoke the second suspension period if an order had not been previously entered. In attempting to lessen the lag the Pennsylvania commission recently has suspended the proposed increased rates only for the initial six months, making an over-all lag of eight months after filing. The record in each case generally is based upon a prior period of approximately one year before filing, so that an over-all lag of eighteen

months frequently results before increased rates are in effect. In a recent case of the Peoples Natural Gas Company a filing of increased rates made on October 15, 1951, to become effective December 15th was suspended for six months and became effective June 15, 1952. The company had commenced paying higher rates for purchased gas in December, 1951, rates fixed by the Federal Power Commission, and so for a period of more than six months these increased costs were being incurred without any opportunity of reimbursement.

These examples are sufficient to emphasize the seriousness of the condition facing the utility industry in this spiral of ever-increasing costs. The important thing is to devise and put into effect remedies that will reduce the lag to a minimum.

Regulatory Attitude

I AM convinced that the best solution to this problem lies in securing affirmative co-operation from the public utility commissioners and staff officials who primarily are responsible for the administrative action in granting increases in rates. We must keep them advised of the financial loss that constantly is taking place and which harms consumers as well as investors, and devise means to minimize the lag without subjecting the regulatory authorities to criticism. Generally, I have found the state regulatory authorities sympathetic in their approach to our problem. A far greater difficulty is the attitude of municipal officials who seek to make political capital of rate cases. All of us have these experiences.

The city of Pittsburgh, through its mayor and city solicitor, constantly engages in newspaper tirades against the Pennsylvania commission and the utilities seeking increased rates. They now are urging a repeal of the statute which permits rates to become effective after a suspension period, prior to the issuance of a final order. If that effort is successful the lag will increase many fold as the rate case load of that commission is extremely heavy. The fact that refunds may be ordered of rates collected and found not to be justified seems not to impress these officials that consumers will be protected against unjust demands.

THE Federal Power Commission as yet shows no apparent concern over the lag which results from its suspension power. The Natural Gas Act, § 4(e), states that the commission may suspend the operation of a schedule "but not for a longer period than five months beyond the time when it would otherwise go into effect." Thus the authority is clear that the commission may suspend for a period shorter than five months, at the end of which the rates may be put into effect under bond.

This point was presented to the commission in a case involving Hope Natural Gas Company of West Virginia (Docket G-1292). The company requested the commission to shorten the suspension period to one month, at the end of which the rates would have become effective under bond. This was refused.

The final order of the commission granted 85 per cent of the requested increase, and the opinion clearly disclosed that for a year prior to the filing of the increased rates Hope's earnings had been at a confiscatory level. Upon the entry of the order granting the increased rates, the company requested the commission to make such rates effective from the beginning of the suspension period rather than from its end, in order that the loss incurred during the five months' suspension could be recouped. The commission refused to do this on the ground that it had no authority to make its rate orders retroactive. In this interpretation the commission was sustained by the court of appeals for the fourth circuit (Hope Nat. Gas Co. *v.* Federal Power Commission, 196 F2d 803; CA 4th, 1952). Thus the commission strictly exercised its statutory rights, despite the unjustified lag resulting. Had it tempered this extreme legal position with equity and justice, four months' confiscation would have been avoided.

As a result of such a policy the practice has developed to file for increased rates early enough so that the end of the suspension period will coincide with the onset of increased costs. In this way it has been sought to reduce the lag. In a case now on hearing before the Federal Power Commission involving proposed increased rates of Texas Eastern Transmission Corporation, staff counsel moved to dismiss the company's proposed rate increases on the ground that the basic material filed with the rate schedules did not show that increased costs would be experienced either at the date when the increased rates were to become effective or at the end of any suspension period. It apparently is the attitude of that staff that there must be a period of actual operation at less-than-reasonable rates before increased rates can be collected under bond. If the commission would approve this viewpoint then the lag certainly would be increased from a six months' minimum to one year or more.

Unless a more helpful attitude is developed respecting the financial problems of utility companies there will be little hope of meeting increased costs as they arise.

Shortening the Suspension Period

A FAIR way of shortening the lag would be to reduce the suspension period. Under the Interstate Commerce Act the initial period of suspension was 120 days with a provision for further suspension for six months (§ 15, 36 Stat 539, 551). In 1920 the suspension period was reduced to five months (§ 15(7), 41 Stat 484, 486-487); in 1927 it was increased to seven months (§ 15(7), 44 Stat 1447-1448). In the last Congress a bill was introduced to permit general railroad rate increases to take effect after the 30-day notice period, without any suspension whatever (S 2518, 82nd Congress, 2nd Session).

Amendments to statutes proposed by utility companies face difficulties innumerable, but legislative change is not necessary. The suspension laws are not mandatory but permissible. The way is open for a constructive solution in those states having such statutory provisions. A suspension of one month and the obligation to refund any portion of the rate found not justified would protect the utility and not harm the consumer.

Use of Interim Rates

MOST of the state commissions have authority to prescribe temporary rates pending investigation, with appropriate provisions for making refunds, or prescribing supplemental rates, thereafter.[2]

Usually these requests for interim rate relief are acted upon after an abridged hearing or series of hearings in which the necessary facts to establish a need for minimum relief have been presented. In some instances, temporary rate relief is granted after the company's case in chief but before cross-examination and rebuttal testimony.

Retroactive Increases

IN a few instances the statutes of individual states permit a rate decrease to be put into effect retroactively. Thus in Pennsylvania the Public Utility Act provides that where in any proceeding involving rates the commission determines that any rate received was unjust or unreasonable the commission has the power to require the utility to refund "the amount of any excess paid . . . within two years prior to the date of the filing of (any) complaint" (Purdon's Pennsylvania Statutes Annotated, Title 66, Public Utility Code, § 1153(a), Refunds). No comparable clause appears to exist which permits any additional collections to be made by the utility in the event a rate is found to be unjustly or unreasonably low.

The Federal Power Commission has, however, by an interesting construction of its authority granted under § 4(d) of

[2] "State Commission Jurisdiction and Regulation of Electric and Gas Utilities," Federal Power Commission. Note: "Use of the Refund Device in Rate Regulation," 63 *Harvard Law Review* 1023-1035 (1950).

the Natural Gas Act and the similar provisions of the Federal Power Act, permitted certain rate schedules to become effective without complying with the 30-day notice required in the absence of a contrary commission order. In one gas rate increase filing the commission, by order issued July 13, 1949, permitted a gas rate increase of $90,000 a year (a 35 per cent increase of prior rates) to take effect without hearings or suspension as of December 1, 1948 (*Re* West Texas Gas Co. 8 FPC 987; Release 4341 (G-1581) dated July 14, 1949). Similar filings showing increases for charges in electric power have apparently also been made effective retroactively by approving certain contracts which bore prior dates (*Re* California Electric Power Co. Docket No. E-6269; Brief of Federal Power Commission, California Electric Power Co. *v.* Federal Power Commission, Case No. 12987 (CA 9th, 1952)). In this respect the Civil Aeronautics Act provides specific authority for making rate increases retroactive to the date of the company's initial application (Civil Aeronautics Act, as amended, § 406(a) 49 USC, § 486(a)) and the commission's authority so to make its orders retroactively effective has been upheld by the Supreme Court (Transcontinental & Western Air *v.* Civil Aeronautics Board (1948) 336 US 601).[3]

There is, therefore, some authority which would permit retroactive increases to be made effective if the individual regulatory commission concerned can be convinced to make its orders so effective.

Interim rate procedure, where available, can be used to soften the impact of the lag, avoid financial loss, and promptly to restore a fair return. It requires understanding and sympathetic treatment with freedom from technical objections representing a narrow view of authority.

Cost of Service Plans

A PROCEDURE formerly successful and which should be re-examined for future usefulness is the so-called cost of service or sliding-scale or rate adjustment plan.[4]

The most notable of these plans was the one originally adopted by the Potomac Electric Company in 1923, and modified in 1944, in the District of Columbia (*Re* Potomac Electric Power Co. 55 PUR NS 65 (DC, PUC, 1944) affirmed 66 PUR NS 496, 158 F2d 521 (C. A.D.C. 1946) certiorari denied (1947) 331 US 816) and a similar plan of Washington Gas Light Company (*Re* Washington Gas Light Co. 53 PUR NS 321 (DC, PUC, 1943) set aside 54 PUR NS 193, 55 F Supp 627 (D.C.D.C. 1944); Washington Gas Light Co. *v.* Vinson (1944) 321 US 489, 52 PUR NS 257).

The plans were effective in providing quickly needed rate increases, $2,750,000 of an electric rate increase requested by Potomac Electric on May 17, 1948, having been made effective by commission order on July 8, 1948 (Order No. 3397).

These plans have been abandoned, but it is doubtful if the companies have fared any better on the whole, and Washington Gas Light Company was unable to make a rate increase effective which might have been allowed if its sliding-scale plan had remained in effect (Washington Gas Light Co. *v.* Baker (1950) 89 PUR NS 177, 188 F2d 11 (C.A.D.C., 1950) certiorari denied (1951) 340 US 952).

Potomac Electric now is in court defending the first rate increase granted after the abandonment of its sliding-scale plan (*Re* Potomac Electric Power Co. 89 PUR NS 483 (DC, PUC, 1951)).

The method has been successful in

[3] 79 PUR NS 476.

[4] See, generally in this regard, the report of the committee on public utility rates, "Methods of Shortening Rate Cases and for Reducing the Costs Thereof," National Association of Railroad and Utilities Commissioners, Proceedings, 1940. Specific authority for the promulgation of sliding-scale plans is found in California, Public Utilities Code, 1951, § 457; District of Columbia, D.C. Code, 1940, §§ 43-101(18); New York Public Service Law, 1939, § 66, Subdivision 16; and Wisconsin, Wisconsin Statutes, 1939, § 196.11. Other plans, however, appear to have been established by agreement without specific statutory authority.

street railway fare regulation. For some years the Cincinnati Street Railway Company has been operating under a municipal ordinance which provides for a special fare control fund with minimum and maximum limits. Increases or decreases from these limits are accompanied by one-half cent decreases or increases in the fare until the fund is restored to the specified range.

The application of service at cost plus a designated return computed on semi-annual net investment computations has been approved by the Federal Power Commission for Trunkline Gas Company in its sales to Panhandle Eastern Pipe Line Company.

The possibilities that such plans offer in reducing the lag in meeting increased costs should be examined and considered.

Adjustment to Specific Costs

To the electric and manufactured gas utilities, coal and oil represent a major item of cost, just as purchased gas does to utilities distributing natural gas. Increases in the costs of these commodities can be recovered through the use of fuel and purchased gas adjustment clauses.

In the electric field the use of such clauses has been widespread, the Edison Electric Institute having estimated as far back as 1948 that over 85 per cent of all private power companies had fuel adjustment clauses in rates for electricity sold to industrial consumers. A survey by the American Gas Association shows fuel adjustment clauses have been adopted by both manufactured and natural gas companies in a number of states. Apparently this method has not been found practicable for railroad, transit, water, and communication companies. Perhaps the day will come when to every railroad ticket there will be added a coal or diesel fuel oil surcharge, just as extra fare is paid to ride on the Super Chief.

Fuel adjustment clauses fall within one of two types, the competitive clause or the cost clause. I understand that in California most of the clauses are of the competitive type and are principally applicable to interruptible and industrial service (*Re* Pacific Gas & E. Co. 49 Cal PUC 107, 51 Cal PUC 285 (1949, 1951); *Re* Southern California Gas Co. 50 Cal. PUC 143 (1950); Riverside Cement Co. et al. *v.* Public Utilities Commission of California et al. (1950) 84 PUR NS 40, 35 Cal 2d 328. In other jurisdictions the tendency is to make these fuel adjustment clauses of the so-called cost type (*Re* New York Edison Co. 10 PUR NS 244 (NYPSC, 1935); *Re* Uniform Fuel Clause, 54 PUR NS 57, 57 PUR NS 25 (Conn PUC, 1944, 1945)).

In the competitive type clause gas or electric rates are increased or decreased a specified amount for a stated increase or decrease in the price of competitive fuels. Thus, gas or electricity can be sold in competition with other fuels, and increases to automatically recoup additional revenue can result without the necessity for full rate proceedings when such competitive prices rise. Occasionally floors or ceilings limit the range of permissible variation.

In the cost-type clause gas or electric rates are increased or decreased in relation to the increase or decrease in the actual cost of coal, oil, or other fuel purchased by the utility, the amount reflected in the final rates of electric companies being based on a certain determined efficiency in BTU per kilowatt hour.

Although the cost of purchased gas represents a larger percentage of total costs of natural gas distributing companies than does the cost of fuel to electric companies, the use of adjustment clauses is not as widespread, yet the problems of determining conversion or combustion efficiencies do not exist in natural gas distribution companies, the natural gas distributed being the identical gas purchased. Many of the gas adjustment clauses appear to be carry-overs from manufactured gas operations, and there are even evidences of the abandonment of such clauses on the introduction of natural gas (*e.g.*, Public Service Electric & Gas Company (New Jersey) on the introduction of natural gas from Texas Eastern Transmission Corpora-

tion). In view of the increasing price of natural gas in the field, and the numerous rate increases filed by interstate natural gas pipelines, there is sound reason for the extension and more widespread use of purchased gas clauses throughout the natural gas industry.

I KNOW of one gas utility which is planning to seek approval of an adjustment clause which will operate to increase or decrease the rate per MCF to its consumers in steps of one-half cent or more upon a similar increase or decrease of the cost of purchased gas. Faced with successive increases in the rates of pipeline companies under regulation by the Federal Power Commission, this method would reduce the time lag of passing on those increased costs. The plan is to compute the cost per MCF of gas every quarterly period in relation to a previously determined cost, and the increase or decrease would be reflected in the bills for three months. Since pipeline companies may collect increased rates under bond and the final rate may not be known for many months, provision will be made for refunding to the local consumers any refund received from the pipeline.

The necessity for local utilities passing on increases being collected under bond by pipelines has been recognized by the Michigan legislature which last June passed an amendment dealing specifically with gas rates regulated by the Federal Power Commission. The Michigan commission is authorized to consider as an operating expense the rates being collected under bond, with a subsequent refund being possible if the collected rates are reduced (Michigan Compiled Laws of 1948, § 460.6b).

Taxes and labor costs constitute an equally important expense but these involve many complications. If a start can be made on the items of relative simplicity, progress may be such that other major items of cost will be treated in this fashion. Thus a partial cost of service plan could result and the lag in revenues substantially reduced.

Summary

I HAVE said nothing about the possibility of reducing the lag through court action. So long as the regulatory commission is proceeding with reasonable speed there is no available legal action to compel a decision before the commission has reached a conclusion. If any commission arbitrarily refused to proceed in due course to hold hearings and decide a case, mandamus would be available in many jurisdictions; but the commissions are working in the usual manner of processing rate cases so that rarely will such a situation develop. Particularly where rates may be put into effect under bond, the fact of confiscation during the suspension period seems not too contrary to constitutional standards where the suspension period is reasonable and serves to maintain the status quo during the investigation of the proposed rates (Hope Nat. Gas Co. *v.* Federal Power Commission, 196 F2d 803, CA 4th (1952)).

There is much that can be done if we can only convince the regulatory authorities of the necessity for speedier relief of a temporary nature, with greater use of the collection of rates under obligation to refund. With a co-operative and sympathetic attitude on the part of commissioners and staff the lag could be made *de minimus*. It is the mission of utility lawyers to devise arguments that will produce that result.

The Regulatory Lag in the ICC

BY ALLAN P. MATTHEW*

THE subject for discussion at this time has been phrased in conventional parlance as "the regulatory lag." In more informative terms it may be stated as "The time required in securing increases in public utility rates in order

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to meet major increases in operating expenses." The task which confronts us is to appraise the problem realistically, to recognize its ominous portents, and thereupon to suggest means for relief. If adequate remedial action should appear to be difficult of attainment we may at least propose measures by way of alleviation.

Appraisal of the Problem

It is not easy to present this problem in general terms. Comprehensive and informative treatment would require review of general rate proceedings before the Interstate Commerce Commission and other Federal rate regulating tribunals and cases of cognate character before the several state public utility commissions. It would be necessary to consider cases involving the rates of carriers by rail, highway, water, and air, and cases dealing with rates of the entire gamut of public utilities. Time limitations preclude any such extended effort. In order to keep this inquiry within practical bounds the case treatment must be illustrative merely and the treacheries of generalization must be avoided. General railroad rate increase cases before the Interstate Commerce Commission, and related cases before state commissions, are believed to be pertinent and instructive. These have their fellows throughout the broad public utility field, and the narrow scope of case inquiry need not give rise to misleading inferences or erroneous conclusions. Such will not be intended in any event.

General Rate Increase Proceedings Before Interstate Commerce Commission

The Interstate Commerce Commission has found it necessary to allow no less than twelve general increases in railroad rates since the cessation of hostilities in World War II. The commission has said that "The successive proceedings 'have grown out of the effort to keep rates on an adequate basis in a time of increasing inflationary tendencies.'" The quoted words are from the commission's public announcement of April 14, 1952, issued concurrently with the release of its report on second further hearing in Ex Parte No. 175, Increased Freight Rates, 1951, 284 ICC 589 (*Traffic World* of April 19, 1952, page 18).

The Interstate Commerce Act does not require in express terms that petitions be filed by the carriers for authority to establish increased rates. The carriers have the right to publish and file tariffs accomplishing such rate increases, subject to the commission's power of suspension and investigation. The burden of justification is upon the carriers. As a practical matter, however, particularly by reason of a mass of unexpired orders prescribing rates, the carriers must proceed by way of petition. Without relief from these outstanding orders increased rates could not be published and filed. Of necessity, also, these petitions are industry-wide in character, commonly reflecting industry-wide increases in transportation costs. To a preponderant extent wage increases resulting from awards of arbitration and emergency boards under the Railway Labor Act have afforded occasion for advances in the rate structure. Such wage increases have frequently been retroactive in application and have produced increases in operating costs to the extent of several hundred millions of dollars annually.

It would be unfair to minimize the burden cast upon the Interstate Commerce Commission by such proceedings. They represent but one chapter in the work of a heavily overburdened commission and it is clear that the commission recognizes that this is a chapter of prime importance and that it must put forth earnest efforts to discharge its responsibilities under the law. Action is not taken in *pro forma* fashion. Hearings are held. The carriers must justify the proposed rate increases and representatives of the shippers and of the public generally are afforded opportunity to be heard. Time is required not only for hearings, and commonly for briefing and

oral argument, but the commission must have opportunity for deliberation and for arriving at properly advised conclusions. These proceedings are commonly styled revenue rate cases in contradistinction to what may be termed conventional rate cases in that the main objective is to determine the carriers' revenue needs and to permit such general advances in the rate structure as will safeguard the economic soundness of the carrier industry. However, the commission has often found it necessary to authorize advances in varying measure for different segments of the rate structure as well as for different areas, and to provide, by way of exception or otherwise, for the whole or partial exemption of particular commodities or movements. All of this is well understood and requires mention only in recognition of the scope and difficulty of the commission's problems.

At this juncture we may address ourselves to illustrative cases.

EARLY in April, 1946, two arbitration boards, constituted under the provisions of the Railway Labor Act, made awards for wage increase of 16 cents per hour for many classes of railway employees, retroactive to January 1, 1946. At approximately the same time a presidential emergency board made a report recommending a similar wage increase for other classes of railway employees. It was estimated that these wage increases would add more than $600,000,000 annually to railroad operating expenses and that, in conjunction with increased costs for material and supplies, the aggregate increase in railroad expenses for 1946 would approximate $800,000,000. On April 15, 1946, the rail carriers petitioned the Interstate Commerce Commission for a general increase in rates of approximately 24 per cent. After preliminary hearings the commission entered an interim order on June 20, 1946, authorizing an average rate increase of approximately 6½ per cent, to be effective on July 1, 1946. After further hearings the commission made its final order on December 5, 1946, authorizing a general rate increase of about 17.6 per cent, effective on January 1, 1947. (Ex Parte No. 162—Increased Railway Rates, Fares, and Charges, 1946, 266 ICC 537.) Thus a period of two and one-half months elapsed between the filing of the petition and the effective date of the nominal rate increase initially authorized, while eight and one-half months passed before the full measure of the needed rate relief could be realized. This was the period of the regulatory lag. In the meantime the impact of increased costs had been borne by the carriers, and had in fact been borne for a full year as far as the increased wages were concerned.

IN the most recent general rate increase proceeding before the Interstate Commerce Commission (Ex Parte No. 175, Increased Freight Rates, 1951), the carriers filed their petition on January 16, 1951, asking a general rate increase of 5.9 per cent. On March 12, 1951, the commission authorized an interim rate increase of 2.4 per cent. On March 28, 1951, the rail carriers filed a supplemental and amended petition seeking authority to increase freight rates and charges by 14.8 per cent, with certain exceptions. On August 2, 1951, the commission authorized increases of 9 per cent within eastern territory and 6 per cent elsewhere, with certain exceptions. On October 19, 1951, the rail carriers petitioned for reconsideration, seeking the full increase which had been asked on March 28, 1951. On April 11, 1952, the commission made its order authorizing the full amount of the increase sought, with certain limitations and exceptions.

The period of the regulatory lag in this instance cannot justly be attributed in its entirety to the commission's procedure, but it must nevertheless be recorded that the "lag" from the filing of the carriers' supplemental and amended petition for an increase of 15 per cent in rates until the issuance of the commission's final order, was more than a year.

IN other instances the elapsed time between the filing of the petition and

the effective date of the authorized rates was less, and justice to the commission requires that this be recognized. It must also be borne in mind that in certain instances, including Ex Parte 175, the commission found it appropriate to authorize interim rate increases which afforded the carriers some measure of relief.

The original appendix to these remarks contained a copy of a tabulation furnished by the Interstate Commerce Commission to the Senate Committee on Interstate and Foreign Commerce with a report dated April 9, 1952, summarizing the general rate increase petitions and decisions since World War II. When the procedures in these several cases have been reviewed as a whole it is clear that the railroad industry has been under the necessity of furnishing its vital public service throughout extended periods at rates which were later determined to have been gravely inadequate.

THE cumulative effect of this inadequacy of revenue throughout periods which in the aggregate are extensive must be obvious. It has been estimated on the part of the rail carriers that if the commission had permitted the full general rate increases sought by the carriers to become effective thirty days after the petitions were filed, and if only 84 per cent of such increases had been realized, net railway operating income in the 5-year period 1946-1950 would have exceeded the actual by $1,949,000,000, or $390,000,000 per year.

It has been further estimated that if the increases ultimately authorized by the commission had been made effective thirty days after the filing of the petitions, and 84 per cent of such authorized increases had been realized, net railway operating income in the 5-year period would have been greater than the actual by $601,000,000 or $120,000,000 per year. Thus needed revenues have been withheld in hundreds of millions of dollars. These revenues have been lost irretrievably since rate increases cannot take effect retroactively in common with the habit of wage increases.

State Regulation

IN dealing with the regulatory lag at the state level the treatment must again be illustrative and, indeed, selective in character. There are marked differences in the public utility statutes of the several states and there have been material differences as well in the practices of the various commissions in proceedings involving increases in rates. The entire field cannot be encompassed in brief survey and this means that a proper general appraisal cannot be made. Our problem is the regulatory lag and we must consider it where it is found to exist.

It is a pleasant duty to record that a number of the state regulatory commissions have acted with commendable promptness, and in realistic fashion, in ruling upon requests by the rail carriers for relief from inadequate rates. The requested increases in state rates have commonly corresponded with the increases requested in interstate rates, and state action has taken place either concurrently with or shortly after action by the Interstate Commerce Commission and in desirable conformity therewith. It must be reported, however, that a disconcerting number of the state commissions have exhibited reluctance in authorizing general railroad rate increases, being frankly unwilling to follow the lead of the Interstate Commerce Commission, and no less unwilling to recognize the carriers' need. Bearing in mind that these are revenue rate cases, it seems inherently unjust to exempt the intrastate shippers of particular states from their share of the burdens which should be borne by the shippers of the country as a whole in order to provide the revenues required for the maintenance of sound and adequate and continually improving transportation services. In dealing with these revenue rate cases the entire rate structure of the country should be the criterion and it would seem reasonable and appropriate that the lead of the Interstate Commerce Commission should be accepted by the several states, subject to their reserved powers to correct any resulting injustice.

THE public utilities commission in one of the states refused to authorize any increase in intrastate rates or fares in common with increases in interstate rates and fares authorized by the order of the Interstate Commerce Commission in Ex Parte No. 162, and notwithstanding that such increases were permitted in most of the states. The carriers were finally under the necessity of pursuing the extreme course of filing a § 13 petition with the Interstate Commerce Commission with a view to obtaining an order requiring rate increases in the particular state.[1] Not only was there great delay on the part of the state commission in affording hearing upon the carriers' petition and further delay in making an adverse ruling, but there was additional delay entailed by the § 13 proceeding. Eventually the § 13 order was made requiring the increases in state rates and fares but they could not take effect until two years and eight months after the interstate increases had become effective.

This is an exceptional case, and of an extreme character, but it exemplifies what has taken place and what may be expected to recur in the absence of cordial co-operation on the part of the state commissions with the Interstate Commerce Commission in meeting the revenue needs of the rail carriers. Additional § 13 cases are pending and doubtless more are in prospect.

IN a disturbing number of cases the authorizing orders of the state commissions have not only been made after appreciable delay but have been attended with numerous exceptions. Such delays and exceptions are to be deprecated. Doubtless there may have been justification in some instances but these delays make their contribution to the regulatory lag and it would seem that exceptions could preferably be made following general authorization, in pursuance of what have heretofore been termed the reserved powers of the state.

Passing from rail revenue rate cases to public utility cases generally, it is again an agreeable duty to state that apparently an increasing number of state commissions have been alert to recognize the need of sustained and adequate earning power. Upon a proper showing on the part of the utility, and frequently in brief and in somewhat informal proceedings, the requested rate advance has been promptly authorized. In many instances the increased rates have become effective upon short notice. Thus the period of the regulatory lag has been reduced well-nigh to the vanishing point. Such expedition in the administrative process is gratifying and surely it is not hostile to public interest, particularly in view of the continuing power of the state commission to remedy injustice and correct error in any form.

IT must be stated, however, that there have been many cases in which the refusal or delay of the state commission to permit increases in public utility rates has worked substantial injustice. One case has been noted in which a highway carrier filed with the state public utility commission a tariff increasing its rates in order to meet substantial increases in operating costs. This tariff was suspended by the commission pending investigation and hearing. Despite publicity given to the hearing, no public protest against the proposed increases was registered. After extensive hearings the commission made its order approving the suspended tariff and permitting the increased rates to become effective upon one day's notice. This order was made nearly eight months after the filing and

[1] Section 13 of Part I of the Interstate Commerce Act contains provisions authorizing the commission, upon petition of the carriers, to determine, through hearing and investigation, whether rates made or imposed by authority of any state cause undue or unreasonable advantage, preference, or prejudice between intrastate commerce on the one hand and interstate or foreign commerce on the other hand, or any undue, unreasonable, or unjust discrimination against interstate or foreign commerce. Upon so finding the commission is empowered to prescribe rates which, in its judgment, will remove such advantage, preference, prejudice, or discrimination. The requirements of proof are exacting and expedited procedure has not commonly been experienced.

suspension of the tariff and throughout this entire period the utility was under the necessity of providing service at inadequate rates. Additional cases, substantially in parallel, and some even more aggravated in character, could readily be instanced.

In another case a public utility undertook to advance its rates by filing its schedule of increased rates with a state commission. Hearings were held and, some eleven months after the filing of the schedule, an order disallowing the increases was made. Pursuant to the applicable statute the utility brought a suit in equity in the supreme court of the state seeking relief against the commission's order, and in due course a decree was entered requiring the commission to authorize certain increases in rates. The final decision of the court issued approximately two years and ten months after the filing of the schedule of increased rates with the commission. Thus the lag in the administrative proceeding was for eleven months and the entire lag in the rate-making process was for a much greater period. This case does not stand alone, and doubtless there will be recurrences, but we may hope that they will be infrequent. The essential supremacy of the administrative authority over public utility rates is desirable but it is no less desirable that it be so exercised as to minimize the regulatory lag as well as to insure continuing adequacy of the rate structure.

It must again be emphasized that we are here exemplifying the regulatory lag and of necessity are avoiding generalization. The problems which confront the administrative authority are not always easy of solution and the burdens which are borne are substantial. All that can be here undertaken is to develop the harmful consequences of the lag wherever it is found and to suggest means for their frustration.

The Portents

What are the portents? As to the railroad industry the alarming consequences issuing from the failure of regulation to keep pace with inflation stand clearly forth. The Interstate Commerce Commission has registered grave concern by reason of the serious threat to the transportation industry posed by mounting costs of operation. The following brief excerpts from the concluding paragraphs of the commission's first interim report in Ex Parte No. 166, Increased Freight Rates, 1947, 269 ICC 33, 53, are representative of the commission's repeated warnings:

> Railroads, like many other industries, are vulnerable to inflationary forces or to sudden and sharply ascending costs. They are large and regular employers of labor, and are also heavy purchasers of fuel and various other materials and supplies; hence, they are directly affected by increases in costs occurring in any of these different categories. Sharp price increases have occurred in all of such categories. . . .
>
> It is clear to us, however, that increasing costs of operation now pose, and unchecked will continue to pose, a serious threat to the maintenance of adequate transportation service; that the railroads as a whole, and many of the most important railroads of the country in particular, are definitely facing such a threat at the present time; that the public vitally needs an efficient transportation service, and imperatively demands a transportation system that is adequate for the national defense in any emergency.

There have been many other expressions of similar import both by the commission and other public bodies.

There are many evidences of approaching strains issuing from the inadequacy of railroad earnings. The continuing reduction in working capital should give rise to serious concern. The decline in the net working capital of class I railroads during the 7-year period from 1945 to 1951 is disclosed by the following table:

Net Working Capital

1945	$1,659,219,109
1946	1,256,725,475
1947	870,262,818
1948	745,613,620
1949	657,609,057
1950	806,143,711
1951	530,724,000

This reduction of more than one billion dollars, the figures for 1951 being less than one-third of the figures for 1945, cannot be regarded with complacency. It must be realized that the regulatory lag is largely responsible for this erosion of capital.

In the report of the commission on second further hearing in Ex Parte No. 175[3] the "Credit Position of the Railroads" has been subjected to thoroughgoing examination (page 617, *et seq.*). Under the subcaption "Deterioration of Current Position," it is said that "The roads emerged from World War II in excellent financial condition" but it is found that a marked decline has taken place. The commission says, *inter alia*, on page 624:

> The ratio of current assets to current liabilities, including material and supplies, has declined each year with only a single interruption from 2.21 on December 31, 1946, to 1.64 on December 31, 1951. . . .
>
> Excluding material and supplies from the calculation, the current ratio has fallen from 1.79 on December 31, 1946, to 1.23 on December 31, 1951. . . .
>
> In view, however, of the large volume of gross capital expenditures expected in 1952 and immediately subsequent years, as well as the rising interest rates on equipment obligations, we regard the declines in the ratios referred to as most serious.

Not only is the commission disturbed by these declines but it also takes note of deferred maintenance. The following is quoted from page 626 of the commission's report:

> In a recent railroad maintenance study made by the engineering section of our bureau of valuation, in evidence herein, the deferred maintenance on railroad property was estimated to total $1,050,000,000 on December 31, 1951.

The commission's report in its entirety merits thoroughgoing study but these brief excerpts will adequately serve our immediate objective.

These are not to be regarded as disquieting symptoms merely—they are evil auguries of far-reaching consequence. The loss in working capital, decline in the ratio of current assets to current liabilities, and the increase in deferred maintenance have issued largely from revenue inadequacy, and revenue inadequacy has issued primarily from the regulatory lag. Continued revenue inadequacy will inevitably yield both a loss in vitality and deterioration in service.

As far as public utilities in general are concerned the mischiefs wrought by the "lag" have the same quality as the mischiefs visited upon the railroad industry. There are differences in degree and divergencies in other respects but the harms already experienced and the dangers presently in prospect have attracted increasing attention in many quarters, including the regulatory authority. The working of economic law is inexorable; it cannot be violated with impunity. The public utility industry cannot truly succeed, nor can regulation itself be truly effective, unless revenue inadequacy and capital erosion shall be checked. The "lag" must be brought under control.

Accomplices of the Lag

The "lag" is the chief but not the sole culprit in producing revenue inadequacy and capital erosion. It has some vigorous accomplices. One of the most potent contributors to the disturbing consequences of the "lag" is the exercise of the rate-making power in such manner as to authorize minimum reasonable rates only. This concept of rate making on the part of the administrative au-

[3] Ex Parte No. 175, 284 ICC 589 (April 11, 1952).

thority has proceeded from misapprehension of the so-called "rule" expressed in Smyth *v.* Ames (169 US 466) and later judicial pronouncements. Therein the courts were dealing with their judicial function in reviewing the reasonableness of authorized or prescribed rates, that is, in determining whether they were so low that they should be condemned as confiscatory. It was not intended that the rule should be used by the regulatory authority "as a guide for making, or approving rates" and yet there has been a resulting tendency "to fix as reasonable the rate which is not so low as to be confiscatory." Thus the practice of the commissions has "eliminated the margin between a reasonable rate and a merely compensatory rate." The quoted words are from the dissenting opinion of Justice Brandeis in Southwestern Bell Teleph. Co. *v.* Public Service Commission of Missouri, 262 US 276. A paragraph from Justice Brandeis' opinion, which merits more consideration than it has commonly received, has been included in the appendix. It is there clearly shown that in rate-making practice the commissions have confused the judicial function with the administrative function.[3]

WHAT are the consequences of this tendency or practice in rate making, particularly throughout an inflationary régime? When the rates authorized or prescribed for a public utility are nothing other than minimum reasonable rates in some period, and the public utility suddenly experiences the impact of rising costs and must await the deliberate processes of regulation before reasonable minimum rates can again be secured, and there is a succession of such experiences as inflation proceeds, it is inevitable that in the aggregate of this sequence of periods the public utility will not have been afforded even minimum reasonable rates or a minimum rate of return. The deficiency in one period will not have been compensated if rates are never permitted to exceed minimum reasonable figures. Thus the public utility would not have the uninterrupted economic strength which is a prime objective of regulation.

In the public interest, no less than in justice to the public utility and to investors in its securities, rate-making practice should recognize the wisdom of authorizing higher than minimum reasonable rates, and permit more than a minimum rate of return, in order that protection may be afforded against unpredictable increases in costs and against other uncertainties. This is necessary if we are to reckon with inflation in realistic fashion.

A SECOND accomplice, perhaps not to be dissociated from the first, is found in the all-too prevalent disposition of regulatory authority to adhere to original cost, commonly depreciated, as the rate base, ignoring the meaning of inflation and disregarding its consequences.[4]

In simple logic it should be plain that a rate base predicated upon original cost, historical cost, or prudent investment has been rendered indefensible by reason of inflation. Its continued use produces revenue inadequacy as well as a partial confiscation of capital. Fifty-cent dollars are not equal to 100-cent dollars, nor can they be made equal by administrative fiat. The committee on valuation of the National Association of Railroad and Utilities Commissioners

[3] In Banton *v.* Belt Line R. Corp. (1925) 268 US 413, 422, 423, the Supreme Court said: "A commission or other legislative body, in its discretion, may determine to be reasonable and just a rate that is substantially higher than one merely sufficient to justify a judicial finding in a confiscation case that it is high enough to yield a just and reasonable return on the value of the property used to perform the service covered by the rate. The mere fact that a rate is nonconfiscatory does not indicate that it must be deemed to be just and reasonable. It is well known that rates substantially higher than the line between validity and unconstitutionality properly may be deemed to be just and reasonable, and not excessive or extortionate."

[4] A trenchant discussion of "Currency Debasement and Public Utility Valuations" by Herbert B. Dorau, professor of economics in New York University, will be found in *Technical Valuation*, April, 1950.

makes this statement in its 1949 report:

> . . . Nevertheless consideration should be given to present-day values in arriving at a rate base and reasonable earnings on such base if justice is to be done in all cases.

Herein we find some recognition of the injustice done by unrelieved adherence to original cost as the measure of the rate base. Reference may be made in this connection to "Inflation—What It Means to Utilities and Investors" by Jackson Martindell, president of the American Institute of Management, in the PUBLIC UTILITIES FORTNIGHTLY of June 19, 1952.

STILL a third contributor is represented by conventional depreciation accounting, directed to recovery of original cost and ignoring replacement values. The economic loss resulting from such depreciation accounting has been convincingly demonstrated by Paul Grady, member of the American Institute of Accountants and a partner in Price Waterhouse & Co., in his paper entitled "Impact of Price Level Changes on Utility Depreciation Costs" in the PUBLIC UTILITIES FORTNIGHTLY of June 19, 1952, and July 3, 1952.[5] Mr. Grady says, *inter alia:*

> . . . It seems clear that the significant economic event is not the exhaustion of original cost dollars, but it is the exhaustion of the property itself. If the utility does not collect sufficient funds from the customers to finance the replacement, it has at that point incurred an economic loss. (PUBLIC UTILITIES FORTNIGHTLY, June 19, 1952, page 826.)

Mention of these three accomplices of the "lag" might be thought to be of collateral interest only, but in truth the interest is more than collateral. Each of them contributes to the mischief worked by inflation, the prime mover. All of them are of substantial moment in appraising the consequences of inflation. Firm allies of the "lag," they aggravate its devastation, contributing materially to revenue inadequacies and to the progressive erosion of capital.

Remedial Measures

MEASURES for solution of the regulatory lag may now be considered. "Here is a task for all that a man has of fortitude and delicacy." It would seem in order to consider legislative action and, in turn, relief or correction through administrative rule or practice.

A. Remedy by Legislation.

TWO bills were introduced in the Senate at the most recent session of Congress, numbered S 2518 and S 2519, respectively. S 2518 contemplates amendment of the Interstate Commerce Act, by adding a new § 15b, with a view to reducing the delays experienced in making general adjustments in rail rates to meet rising railroad operating costs. This amendment would authorize the rail carriers to file schedules of increased rates with the commission, certify that they have incurred, or are about to incur, increases in wages or other expenses, and that general rate increases are needed in order to defray such increased costs, and thereupon the increased rates as filed would become effective without advance approval on the part of the commission. The authority of the commission to investigate such increased rates, either as to reasonableness or as to discrimination or preference, and to make appropriate orders for the removal of any ascertained illegality, is preserved. S 2519 seeks amendment of the so-called rate-making principle of § 15a of the Interstate Commerce Act so as to eliminate the language which suggests that only minimum reasonable rates may be authorized, and also so as to restore to railroad management a larger judgment in determining the effect of rates upon the movement of traffic.

[5] See also "Provision for Capital Exhaustion under Changing Price Levels" by Arthur H. Dean in *Harvard Law Review*, Vol. 65, 1339, June, 1952.

THE objectives of these bills appear to be meritorious. It is difficult to discover cogent grounds for objecting to determined effort on the part of the transportation industry to neutralize the regulatory lag. The Senate Committee on Interstate and Foreign Commerce held hearings upon both of these bills, in the course of which proponents and opponents were both heard. A number of objections were registered by the Interstate Commerce Commission. No report was made by the committee and Congress has adjourned. Presumptively these bills will be reintroduced at the next session of Congress. At this moment it can only be said that curative measures through action of Congress are uncertain and that they may be neither prompt nor adequate.

Certain alternatives for S 2518 were submitted to the Senate committee. One of these was a suggested revision of proposed § 15b offered by a majority of the commission. Another, proposed by the National Industrial Traffic League, introduced by Mr. Johnson of Colorado (by request) in the nature of a substitute for S 2518, contemplates the amendment of the act by adding a new section to be designated § 15c.

COMPARATIVE analysis in detail cannot here be attempted but the essential contrast between the philosophy underlying S 2518 and the philosophy underlying the suggested revision of proposed § 15b should be noted. S 2518 contemplates the effective restoration of the responsibility of the carriers in the initiation of rates, while the suggested revision of proposed § 15b might be understood to give statutory recognition to the procedural gloss which has been laid over § 6 of the act under the practices which have developed in these revenue rate cases. In its present phrasing, § 6 does not provide that tariffs increasing rates may not be published or filed without the prior approval of the commission. As heretofore noted, however, the rail carriers find it necessary to proceed by way of petition since they must secure relief from unexpired orders prescribing rates. They must also seek relief from the Fourth Section. S 2518 appears to rest upon a sound philosophy, although this observation should not be understood to suggest that no amendment of the text would be in order. Carriage by rail has ceased to be monopolistic in character and railroad management can reasonably be entrusted with the restoration of its rights and duties in the initiation of rates without apprehension that it will act in hostility to the public interest and, indeed, in hostility to the interest of the railroad industry itself. The commission's existing powers, which would be preserved without serious impairment, should afford salutary safeguards against excesses on the part of railroad management.

IN brief summary, the amendment of the act to be designated § 15c, tendered by the National Industrial Traffic League, representing large bodies of shippers, would authorize the rail carriers to file a petition certifying that they have incurred, or within the immediate future will incur, increased costs which, according to the best available estimates, indicate that a general increase in rates is needed. Within thirty days after the filing of such petition the commission would enter an interim order and findings, with or without a hearing, authorizing such increases to become effective, on not more than ten days' notice to the public, as in its opinion would be appropriate or necessary. Within sixty days thereafter the rate increases would be the subject of further investigation and the commission would proceed with final disposition of the cause in accordance with other provisions of the act. By proviso the carriers would be required to make refunds to the extent that the increases finally determined by the commission would be less than the increases authorized by the interim order.

As far as remedy by state legislation is concerned, and this is no less important than legislation at the Federal level, it is difficult to register optimism respecting relief commensurate with the need. It is to be noted, however, that in

at least eight states helpful legislative relief has been obtained.

B. Relief by Administrative Rule or Practice.

WITHOUT abandoning legislative programs, efforts might well be put forth to persuade the regulatory authority to reduce the lag period by the adoption of rules for expedited procedure in appropriate cases or by summary procedure without implementation in formulated rules. Solution in this fashion, without awaiting what may emerge on the legislative front, may be considered for two reasons: *First,* adequate legislative relief may not be forthcoming promptly and might issue with such attendant exceptions, qualifications, and conditions as to hamper and confuse the administrative process rather than to expedite or clarify it. The regulatory tribunal might thereby be unwisely fettered in procedural matters. *Second,* a wholesome measure of relief may fairly be expected through earnest appeal to the commissions, in proper co-operation with spokesmen for the public interest; that is, those who speak for shippers and the great body of users of carrier and public utility service.

In an effort to be concrete it may be suggested that the Interstate Commerce Commission might well frame a rule, or adopt a practice without the aid of a covering rule, designed to accomplish the objectives of S 2518 and indeed the objectives of the "revised § 15b" proposed by the commission majority and of the amendment tendered by the National Industrial Traffic League to be designated § 15c. The precise phrasing of the rule or practice to be formulated need not be attempted here.

IN these three alternative proposals we have express recognition of the need for expedited procedure, and we have noted that the three members of the commission who did not join in the proposal of the majority have recorded their view that "under the provisions of the act without any further amendment, the commission can expedite the hearings and determination in advance rate cases as rapidly as is required in the public interest." Accordingly, the apparent consensus is that procedural relief is practicable, and it would seem logically to follow that it may be accomplished by rule or practice in advance of appropriate statutory amendment. Such rule or practice would not be discordant with existing statutory provisions.

An excellent precedent for prompt and summary action in general advance rate cases is found in the course followed by the commission in granting general rate relief in Ex Parte 74 Increased Rates, 1920 (58 ICC 220; July 29, 1920). The commission's report shows that the applications of the rail carriers were filed in the latter part of April and the early part of May, 1920, that hearings were held in May, June, and July, 1920, and that the case was submitted upon briefs and oral argument on July 6, 1920. The decision was issued on July 29, 1920, little more than three months after the initial filing of the applications. Thus the regulatory lag was relatively brief and in the meantime the carriers had the protection of the Federal guaranty. True, the circumstances which then confronted the carriers and the commission imperatively called for immediate action. The deficiency in the rate structure was plain to all. But differences in degree of need should not militate against the observance of sound and salutary practice.

IDEALLY, compensatory rate increases should be concurrent with the impact of increased costs, but in so far as the ideal may be impracticable of attainment it may properly be urged that the period of the regulatory lag be narrowed to the greatest possible extent. The lag would, or at least could, largely disappear, and need not be of serious moment, if the accelerated procedure here suggested should become effective. Whatever the objections which could reasonably be voiced they could not outweigh the supreme need for preserving the continuing adequacy of carrier revenues.

We may suggest a parity of procedure,

with appropriate modifications, before other Federal regulatory tribunals as well as before the several state public utility commissions. It may be neither practicable nor necessary to seek the adoption of a formal rule of practice, and the course to be followed could differ with the circumstances of particular cases.

It might be in order, for example, to resort to something in the nature of pretrial procedure. The applicant could be required to certify its needs in such fashion and with such supporting data as the commission would direct and present a prima facie case, either with or without public hearings. Again we have ample precedent in the prompt action commendably taken by many state commissions in authorizing increased rates to meet the impact of suddenly increased costs. An interim order might be made, and the relief afforded should be commensurate with the need shown at the pretrial proceeding. There should be no lag in affording rate relief, beyond such delay as the commission finds to be unavoidable. General rate increases will never be popular but it would seem that public acceptance can most readily be obtained shortly after there is general public knowledge that substantial increases in wages or other costs have taken place.

We cannot here undertake to consider the several problems which may present themselves in particular cases but must be content with urging the adoption of procedural practices which will effectively remove the injustice and cure the blight issuing from the regulatory lag.

C. Rate-making Principles and Practices.

FURTHER remedial measures, already foreshadowed, remain to be briefly mentioned. Efforts should earnestly be put forth to convince the regulatory commissions of the error, so painstakingly pointed out by Justice Brandeis, in understanding that, under the rule or doctrine of Smyth *v.* Ames, the reasonable rates to be prescribed or authorized by public authority are merely those rates which are "not so low as to be confiscatory." It is high time to revive the "zone of reasonableness," and to recognize that within that zone there should be some freedom for the exercise of judgment both in rate making by the public utility and in rate regulation by administrative authority. There must be such freedom for the exercise of judgment in order to provide a margin of safety in earning power. This is especially required in a period when inflationary processes are doing their deadly work. Rates should at all times be sufficient to insure revenue adequacy.

More than this is required. The historical cost rate base has become outmoded by reason of inflation and should be abandoned as untenable. For the same grim reason depreciation accounting cannot achieve its major objective when it is directed to the recovery of cost only, ignoring replacement values.

MANY thoughtful students of public utility problems have become gravely disturbed by reason of the assault of inflationary forces upon conventional rate regulation. A paper by John P. Randolph, entitled "Rate Making and Inflation" in the PUBLIC UTILITIES FORTNIGHTLY of July 3, 1952, is to be commended as necessary reading. Mr. Randolph is the general solicitor of the National Association of Railroad and Utilities Commissioners. He was formerly a member of the Missouri Public Service Commission and also served for a time as its general counsel. His considered views are to be entertained with respect. He there points out that "a number of commissions have found that some of the effects of inflation can be alleviated by placing more emphasis on the future instead of the past." He observes that "it is entirely proper to anticipate what the effects of inflation will be during such period" and reports that in several states allowances have been made for declining earnings "through either the rate base, the rate of return, or by specific allowances of income or by using a future test period."

Temptation to review Mr. Randolph's paper in thoroughgoing fashion must be resisted. It must suffice to offer assurance that Mr. Randolph's views are worthy of sympathetic reception by regulatory tribunals in aid of sound judgment in the exercise of their power over public utility rates.

Conclusions

INFLATION is a grim fact and must be reckoned with in courageous fashion. The regulatory lag is a fact and must be sternly grappled with. Accelerated administrative procedures, accomplished whether by legislation or by rule or practice, will minimize its ravages but reduction of the "lag" cannot be a complete solvent. Rate-making practices should be brought realistically into harmony with the economic consequences of inflation. Authorized rates must be something more than minimum reasonable rates in order to protect against the impact of sudden upward thrusts of operating costs and against other uncertainties. There should be ungrudging recognition that the original or historical cost rate base has been rendered invalid. There should be equal frankness in recognizing that depreciation accounting, directed to the recovery of costs and ignoring replacement values, results in capital erosion.

In the sum of these measures the public utility industry may have the continuing economic health which is indispensable to the maintenance of proper standards of service. Without them the industry will be progressively weakened and capital erosion will proceed unchecked.

Regulatory Lag in Public Utility Rate Making

By HAROLD P. HULS*

DELAY in the granting of needed rate relief to public utilities of all kinds is a matter of vital concern to all, the utilities, the stockholders, the consuming public, and the regulatory commissions as well. Since the subject before the section is "Regulatory Lag," this discussion necessarily must be limited to the lapse of time between the filing of an application for a rate increase and the time of granting the increase, or, more specifically, the effective date of the increase.

Although the subject thus is restricted to the time consumed in proceedings before regulatory commissions in seeking and obtaining rate relief, it should be remembered that utility management itself has a definite related responsibility to bring to the attention of rate-fixing bodies their need for rate increases and the urgency thereof by timely filing of increase applications to such bodies when the need for such increases becomes apparent to management.

When an applicant delays filing for a requested increase in rates for a long period of time, the regulatory process necessarily is a longer one, since no thorough review of the applicant's books to ascertain its earning position ordinarily has been made. Nor, ordinarily, has there been a review of its practices relative to its additions to plant, maintenance, and other expense, allocations of plant and expenses and revenues as between different services, where the applicant may furnish its consumers and customers with gas and electric service, or, as is sometimes the case, with electric, water, and telephone services.

DEPRECIATION practices may have been in use which might require careful regulatory scrutiny, or possibly exhaustive study and revision to avoid an overaccrual in the depreciation reserve, to place appropriate lives on property, to adopt a more realistic interest rate in keeping with the going rates, or to adopt a different method of accruing depreciation.

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When these elements are present, as has largely been the case, and where rate relief has not been requested for many years, the regulatory task is harder, more voluminous, time consuming, and more intricate, than in the case of the utility which closely follows its earning position, keeps its records and accounts according to regulatory requirements, and makes timely and efficient request for rate relief.

Once a complete overhauling of the practices and earning position of a utility has been made by a regulatory body and relief granted and timely requests for rate relief have been shown to be needed due to a retrogression or slippage in the rate of return, the regulatory task is facilitated.

(a) Determination of Impact and Calculation of Rates

BEFORE management can decide to file for a rate increase, it must determine the impact of the changed condition, due to increased wages or other costs, and it must calculate the rates that will produce the necessary results.

It is a long step from notice of a change in wages of a given class of employees or of a change in the cost of materials or in taxes to the determination of rates that will offset such changes. The dollar effect must first be determined. This calls for a careful study of the number of employees in the class involved, the amount of the material used, and the amount by which the new taxes vary from the old. In the case of wages, particularly if fringe benefits and overtime are involved, it may call for a change in duties or in hours worked. With respect to materials it may become advisable to make substitutions as price relationships change. Taxes may be on payroll, on earnings, or they may be ad valorem or excise. After the impact of these forces has been calculated, rates that will produce the results called for must be developed. This calls for a prognostication of traffic available in a future period, the diversion or attraction of traffic that the new rates will cause, and the effect of a change in total volume or in volume relationships upon the cost of rendering the service. Nothing in this grouping is properly included in the "regulatory" lag.

(b) Preparation of Evidence

IN the absence of regulation no presentation of evidence would be called for. While the work in this regard may serve as a check upon the previous determinations and may be of some value to management, this entire period may well be considered as "regulatory" lag.

In the preparation of its evidence, a utility can aid in the shortening of the time of the hearings, the analysis of the evidence, and the ultimate determination by the regulatory bodies. Statements of witnesses and their testimony, in question and answer form, and the exhibits, can be prepared and served in sufficient time before the hearing upon the commission and prospective parties, most of whom are known prior to the hearing, especially where previous hearings on prior rate increases have been held. Thus study may be given them by the commission staff and the parties before hearings start. Thus the time for cross-examination for clarification purposes, at least, is shortened materially.

Where commission rules permit, as has been the case in certain matters before the Interstate Commerce Commission, and in some state commission matters, after the witness has been sworn and has identified the testimony and exhibits, such statements and testimony may be incorporated fully into the record, as effectively as if each word had been read into the record orally by the witness, subject, of course, to any objection or motion which might be appropriately made thereafter. Here, again, a material shortening of the time of the hearings could result.

So, also, the care with which exhibits and statements of witnesses may have been prepared and presented, so as to give fully their basis, the underlying facts, and the principle or theory on which they rest with appropriate reference to tests, other exhibits, or decisions, makes for

facility of understanding by the commission and the parties and for speedier and shorter hearings.

It is not enough to allege and show that expenses have increased by a certain percentage and request that earnings be increased percentagewise.

Reasonableness of a rate is a question of fact. (Illinois C. R. Co. *v.* Interstate Commerce Commission, 206 US 441, 455, 51 L ed 1128, 1134.) And there is a legal presumption that rates established by authority of law are both reasonable and valid. (Railroad Commission *v.* Cumberland Teleph. & Teleg. Co. 212 US 414, 423, 53 L ed 577, 581; Lindheimer *v.* Illinois Bell Teleph. Co. 292 US 151, 175, 3 PUR NS 337, 78 L ed 1182, 1197; Barton *v.* Belt Line R. Corp. 268 US 413, 422, 69 L ed 1020, 1026.)

One large California utility in October, 1949, applied to the California commission for a uniform 6 per cent increase in its electric rates, the first in thirty years, showing that its return thereby would not be adequate. The request was made to aid its credit position and facilitate the sale of its securities. The utility thought to avoid the greater impact upon the consumer of rates providing a compensatory return and hoped that inflation would not continue and that increased growth in consumers and their use of electricity might prevent the necessity for further increases. The increase was granted in March, 1950. Yet approximately a year and a quarter later it became necessary, in the judgment of management, to file for additional rate increases, varying from 18 per cent to 21 per cent. After thirty-six days of public hearings, participated in by more than 50 cities and counties, as well as by three United States government bureaus, and other protestants, the matter has been submitted and is awaiting decision.

The foregoing is cited not as criticism of management in any sense but rather as illustrative of the forces of inflation in their effect upon our economy, and the resultant difficulty embodied in the tasks of both utilities and the regulatory commissions.

The railroads and various trucking industries also have been before the commissions for percentage increases, starting in 1946 and continuing to the present. Repeated hearings upon the several applications have been necessary in almost every year since the close of World War II, adding to the burdens of the utilities and the commissions.

In addition to the fact that the rate of return found by a commission must be reasonable, the rates themselves must be reasonable and not discriminatory. These cardinal rules impose a burden upon the utilities in the presentation of their requests and upon the commissions in rendering decisions fair and just to the utilities and their consumers.

One applicant water company, in an effort to cut down the time lapse between filing, hearing, and final decision, recently filed its request with the California commission in the alternative (a) to make effective immediately, without hearing, a surcharge of approximately 25 per cent on its existing rates to achieve a 6 per cent return until permanent rates are established, (b) for an immediate hearing and to make immediately effective thereafter an approximate 25 per cent surcharge on its existing rates, or (c) to make effective as of a given date its proposed permanent rates and charges to be filed as a supplement shortly after the original filing sufficient to enable it to realize a 6.9 per cent rate of return. Allegedly, the 25 per cent surcharge would produce considerably less than a fair rate of return and was required to enable the utility to meet its utility obligations and to maintain its financial integrity until permanent rates were established. In another application by the same company a similar 20.5 per cent increase was requested upon rates and charges which had been in effect since 1923.

This utility serves water in widely separated portions of the state and also serves electricity and telephone service in various scattered areas in Cali-

fornia as to which it has requested and received rate increases in other proceedings fairly recently. Each proceeding must be heard and decided on its own merits, entailing the time and attention of the commission and its staff over a period of separate intervals of time, thus leaving the over-all earnings position of the company in doubt until the last of such proceedings has been determined.

This situation is cited not to suggest that one over-all application should have been filed or that a uniform rate should have been requested but to show that the individual treatment by the commission necessitated by such separate filings requires more time and attenion than if request had been made for all at the same time. The separate filings indicate that possibly management itself was not prepared to proceed in any different manner. Again, criticism is not to be implied. The example does illustrate, however, the difficulties besetting both management and the commission where the staffs of each are hard pressed and time is limited.

(c) Hearing

NUMEROUS complaints have been voiced over the lag between the time an applicant seeks a rate increase and the time of hearing, the length of the hearing, and the time the increase is granted. Speeches, brochures, and articles have touched upon various phases of the lag.[1]

Complaints made are that during the lag period a utility must operate unprofitably, perhaps injuring its credit and its long-range ability to serve the public adequately and that since rate increases may not be made effective retroactively, whereas Federal tax and wage increases do operate retroactively, the revenues which would have accrued in the interim are lost forever and the loss is irreparable. One utility specialist, writing on utility equities, complains of the delays in reaching a decision as being a source of irritation to investors in utility equities. He states: "The stockholder can be seriously hurt before relief is granted. If so, the informed investor will shun that jurisdiction."[2]

With respect to Interstate Commerce Commission jurisdiction of railroad rate matters, The Brookings Institution has stated that "The division of authority and responsibility of general rate policy has produced serious problems. First, the attempt of the commission to discharge exacting managerial responsibilities by the use of inflexible and legalistic procedures has resulted in intolerable delays in disposing of general rate cases. The immediate consequence has been a serious impairment of the carriers' financial position. Second, the division of responsibility threatens the long-term prospects for survival of the carriers as privately financed enterprises."[3]

WHETHER the criticism be just or not, the commission is criticized for its adherence punctiliously to statutory requirements for fair hearings resulting, according to The Brookings Institution, in a legalistic and ponderous method of conducting its business, with records of unbearable size and so much time consumed as to defeat the primary purpose for which the administrative agency was created.[4]

While the institution credits the commission with some procedural improvement, it notes a lack of success for the

[1] "National Transportation Policy" (Dearing and Owen — The Brookings Institution, Washington 6, D.C. 1949.)
"Inequalities in, and Inadequacies of, Existing Regulatory Laws" (Grubbs—Association of American Railroads, Washington 6, D.C. 1950.)
PUBLIC UTILITIES FORTNIGHTLY, Vol. XLV, June 8, 1950, page 735; Vol. L, July 3, 1952, page 3; Vol. L, August 14, 1952, page 244.
See, also, "A Restatement of Fundamentals of Utility Rate Making." By Hon. Harold A. Scragg. PUBLIC UTILITIES FORTNIGHTLY, Vol. L, September 11, 1952, pages 347, 349, 350.

[2] "An Analyst Takes a Critical Look at Utility Equities." By Frank D. Chutter. PUBLIC UTILITIES FORTNIGHTLY, Vol. XLIX, May 22, 1952, page 676.

[3] "National Transportation Policy" (Dearing and Owen—The Brookings Institution, *idem*, page 278 ff.)

[4] See, also, address of Commissioner Clyde B. Aitchison, chairman, Interstate Commerce Commission, November 7, 1947.

disposition of general rate cases with any acceptable degree of expedition. It notes the lapse of a full year between the time the railroads felt the impact of increased costs and the date they were permitted to increase freight rates by a corresponding amount in Ex Parte 162, the 1946 freight rate proceeding, and finds no adequate explanation for the time lag. In that proceeding a 6 per cent interim increase became effective July 1, 1946, and the final 11½ per cent increase became effective January 1, 1947. Stating that the major elements of costs of labor and materials that controlled the final decision were known as well in June as in December and that the only major speculative element was the anticipated level of traffic, the institution charges that the commission's delay in deciding contributed to the final deterioration of the regulated carriers. A less serious consequence was noted in the attainment by the railroads of rate adjustments in the 1947 freight rate case, Ex Parte 166. The emergency for the railroads consisted in a substantial wage increase, effective September 1, 1947, and sharp increases in the cost of major railroad operating supplies, resulting in a requested 27 per cent general increase.

THE institute, in discussing regulatory lag, concludes, to quote it, "that so long as the commission exercises its discretion to review and decide general rate cases in the capacity of a board of directors for the railroad industry, expedition will not be attained. It is equally certain from the experience of more than a quarter of a century that the commission will continue to encroach on managerial functions so long as its present legal jurisdiction remains unchanged. Consequently, if the impasse is to be broken, it appears that statutory restraint must be placed on the commission's control over the general level of railroad rates. The question is: Can this be done without jeopardizing the valid objectives of modern rate regulation?"[5]

The institute further concludes, "There seems to be no reason to believe that divesting the commission of jurisdiction over the general level of rates would tend to increase the financial risks of railroad owners."[6]

Whether the charge of invasion of the field of management by the Interstate Commerce Commission is just or not is not the question before us. Judging from what has been said by the institute, and according full weight to its arguments and conclusions, that delay in the granting of rate increases is due to the commission's hearing policy and determination concerning rates which allegedly constitute an invasion of management's responsibility, then, of course, the remedy may be by legislation.

It is surprising, however, that the constitutional guaranty against the taking of private property without due process of law and the safeguards to the equal protection of the laws could have been so lightly considered. One wonders whether, if the situation were reversed and involved a reduction in rates, strong reliance upon those same constitutional guaranties and safeguards would not have been given in the arguments for retention of the existing rates and charges, a reliance to be maintained throughout rate reduction proceedings, including appeals to the Supreme Court of the United States.

IN Hope Nat. Gas Co. *v.* Federal Power Commission decided May 14, 1952, in the United States Court of Appeals, Fourth Circuit, 196 F2d 803, in discussing a suspension by the commission of a proposed new rate for natural gas furnished by the Hope Natural Gas Company to wholesale customers, the court said at page 809:

> It is true, of course, that a utility is entitled to rates that are just and reasonable; but this is not to say that rates must fluctuate automatically with every change in economic conditions or that a reasonable time may not be allowed for determining the reasonableness of a proposed increase in

[5] *Idem*, page 293.

[6] *Idem*, page 303.

rates before it is allowed to go into effect. Any loss sustained by a maintenance of the status quo while such determination is being made is properly considered, not as a violation of constitutional right, but as a necessary incident of rate regulation so long as the period of suspension does not "overpass the bounds of reason." See American Teleph. & Teleg. Co. *v.* United States, 299 US 232, 247, 16 PUR NS 225, 81 L ed 142, 57 S Ct 170, 177; Federal Power Commission *v.* East Ohio Gas Co. 337 US 464, 475, 82 PUR NS 1, 94 L ed 268, 70 S Ct 266. It is not contended, nor could it reasonably be, that the five months' suspension period allowed by the statute is so unreasonable as to amount to a denial of due process. As pointed out by Senator Elkins with respect to the suspension provision of the Mann-Elkins Act, a limited period of suspension pending an investigation of proposed increases is "a reasonable limitation upon the exercise of the property rights of the carrier (utility) in fixing a rate." 45 *Congressional Record* 3472.

There is no contention that the commission abused its discretion in suspending the rates filed nor request that we review the finding that these rates were unreasonable. Even if the order suspending them were invalid for any reason, it would not follow that other rates later found reasonable could be made retroactive because of its invalidity.

An appellate court in Baltimore recently set aside a decision of the Interstate Commerce Commission on the ground that improper notice to interested parties had been given. The court severely criticized the commission, pointing out that the burden of determining who are interested parties is placed upon the applicants when it properly is the duty of the commission to determine who are such interested parties and to see that proper notice is given.

Delays due to duality of jurisdiction have come in for criticism. Lag at the state level has been termed vexatious, since it is necessary for the railroads to appear before the state commissions to endeavor to obtain authority, which in many cases is not fully and promptly granted.[7] The author recommends that § 13 of the Interstate Commerce Act be so amended that where a state has not acted on a petition in such a case within forty-five days after a decision of the Interstate Commerce Commission granting a general increase in rates or fares, the Interstate Commerce Commission be expressly authorized and directed to take jurisdiction upon petition of an interested party and that a proviso be added calling for such cases to be given preference over all others, except general increase cases pending before it, including suspension cases (as to which there is now a provision calling for preference in handling and disposition by the commission), and to be *decided as speedily* as possible.

The author notes:[8]

> The commission has grappled with this problem of lag between increased costs and increased revenues and out of a process of trial and error from which the railroads have suffered, has evolved a technique known as the "interim" increase which has afforded the railroads some relief. Special rules have been designed to expedite its proceedings with extensive use of sworn statements submitted to the commission and interested parties in advance of the hearing and received in evidence, in the absence of objection, without the personal appearance of affiants. Following a hearing, in Washington, at which such cross-examination as is desired by the parties is permitted, the commission proceeds promptly to hear oral argument and thereafter to pass on whether and the extent to which a temporary or interim increase is warranted by the record thus made. The record is then held open and the commission conducts hearings throughout

[7] "Inequalities in, and Inadequacies of, Existing Regulatory Laws"—(Grubbs) *idem*, page 32.

[8] *Idem*, page 31.

the country before passing finally on the entire increase sought by the railroads.

It will be seen that under the described procedure it was a little over three months before the railroads could obtain and make effective the interim increase granted and eleven months before they were able to obtain and make effective the full increase the commission ultimately found they should have.

IN a few large-scale rate increase hearings conducted by the speaker, an attempt was made to streamline procedure and presentation of evidence by the use of so-called "canned testimony" prepared and distributed to all known parties in advance of the hearings with a small degree of success. Human nature being as it is, the expected full cross-examination on such testimony did not occur, for the parties were not fully prepared to cross-examine and after clarifying questions requested further time for cross-examination, a reasonable time for which was granted. Reason existed for such extension as material changes in text of testimony and in exhibits were made at the initial hearings.

In other proceedings heard by your speaker the suggested "canned" testimony method met with objection by counsel for applicants and protestants or, where such testimony was so prepared but not previously served, all parties objected to its incorporation in the record without reading, applicant's counsel believing that its effect thus would be lost and protestants desiring to hear it to enable them to ask questions for clarification. Additional days of hearing increased the presentation of the case. Frequently, if applicant had prepared and served the "canned" testimony in advance of the hearings, his hopes to be accorded the same treatment were dashed by the failure of protestants and staff to do so. Your speaker is not convinced, however, that a preconference ruling by the commissioner hearing the matter requiring all parties to so proceed, and a strict adherence thereto, would not result in shorter hearings.

RETURNING to the question of delay due to duality of jurisdiction, where increases in gas rates sought by an interstate gas transporting company were suspended for the statutory five months' period by the Federal Power Commission, as in the recent case of the El Paso Natural Gas Company, for example, two California utilities have sought to avoid the delay in obtaining the additional revenue necessary to meet their increased costs of out-of-state gas.

These are the filings with the California Public Utilities Commission on August 29, 1952, by Southern Counties Gas Company and Southern California Gas Company, A 33699 and A 33700, respectively. Each company alleges that on January 1, 1953, it will begin to pay higher gas rates to the El Paso Natural Gas Company from which it purchases considerable quantities of gas originating in Texas and New Mexico. Such higher rates are subject to refund after final determination of the reasonableness of the rate by the Federal Power Commission. It is alleged that the increase is of such magnitude—$5,278,000 for the two companies—that any lag in the granting of offsetting relief would drastically impair each applicant's income status and, since the rates cannot be fixed retroactively, each applicant could not recoup such losses.

These applications were filed separately from and considerably after the filing of other applications by each for rate increases due to increased labor, material, tax, and other costs and expenses, not including the Texas gas rate increase. One of these applications has been heard and recently submitted; the other now is in process of hearing.

The California commission is requested in the August filings to authorize each applicant to place into effect a proposed retail surcharge subject to refund, as proposed by a formula set up in each application, together with a subsequent final rate increase as ultimately deter-

mined by the Federal Power Commission.

Here then is an attempt by the utilities themselves to overcome the lag which otherwise would be caused in its California rate increase matters due to the uncertainty of the final determination by the Federal Power Commission as to the increased cost of purchased gas.

An instance of a timely filing and a limitation of the sought increase to the amount needed to make the utility whole as a result of increased wages, so as to effect intrastate rate increases within the shortest possible time after interstate approval, is the application (A 33710) by the Western Union Telegraph Company filed with the California Public Utilities Commission on September 4, 1952, three days after the rates became effective interstate.

The last California rate increase for this company was filed September 21, 1951, was granted January 22, 1952, and was effective February 18, 1952. In some other states such increase became effective on April 1st. After a strike in April and May, 1952, and a resulting wage settlement, the Federal Communications Commission allowed rates interstate, as increased by tariff revisions filed with the Federal Communications Commission, to become effective September 1, 1952, without formal hearing. The application filed with the California commission September 4, 1952, for a corresponding intrastate rate increase states: "Printed notices of the rate revisions are being distributed by applicant to its charge account customers and to members of the public making inquiry at applicant's public office counters."

This is one way that a utility by its own fortuitous action can aid in cutting down the lag.

A CERTAIN portion of the lag is due to the tremendous burden upon commission staff in its analysis of applicants' evidence and preparation and presentation of its own. The large increase in number and complexity of rate filings due to continued inflation has required skillful programming by commissions in the setting and hearing of cases so as to treat each fairly in order of filing, as nearly as possible. In our own commission this has been the endeavor.

Faced with a mounting backlog of pending rate matters, large and small, and a constant turnover in technical staff, our commission has instituted a staff training program, the objective of which is to improve the quality, control of cost of the work, and to reduce the time element in the tasks involved. Streamlining the organization and work of our staff both as to informal complaints and formal rate proceedings has been the order and appears to produce better results. Development of standard practices for the preparation and presentation in evidence of reports in rate proceedings has constituted another helpful step.

Our public utilities division staff deals with more than five hundred utilities, many of which have applied for and received at least one or more rate increases since 1947. Crowded calendars add to the difficulty of expeditious hearings and a commissioner and the staff usually are engaged in three or four large rate proceedings simultaneously, which prevents many of the same staff members from giving individual attention to one matter at a time. Calendar dates also have to be set in accord with the convenience of counsel for applicants, protestants, and staff.

COMMISSIONERS co-ordinate in setting hearing dates and the best attempts possible are made to speed hearings and arrive at early decisions. But large records developed in hearings, sometimes covering thirty to fifty hearing days, require greater time in study and analysis and in the preparation and arriving at a decision. No magic touch can avoid some delay in rate cases at a time such as the present when all utilities are affected in their earnings by the continued increase in costs, wages, taxes, and all items of operating expense. Our commission, as it is believed the case with all regulatory bodies, is doing its best to accomplish the tasks before it with the greatest expedition and the least delay.

(d) Legislative Relief

CERTAIN remedies in procedure may be necessary or desirable. My information is that a member of the staff of the Federal Power Commission, indicating that final disposition of rate petitions takes about a year, in part blames the Civil Procedure Act which makes necessary the intermediate phase of the examiner's report, and believes that, if it could be dispensed with, the lag could be cut in half.

Most state commissions may require prior approval of rate changes and most do so when major rate requests are made. Most of them, likewise, may suspend such changes. By statute, many state commissions may prescribe temporary rates, pending investigation.[9]

Interim rates have been made effective by the California commission as well, usually over objection of protestants. Interim rates, however, are not completely satisfactory to applicants and usually are misconstrued by the public, which believes that increase has been filed upon increase within a period of a few months.

By Senate Resolution 332, adopted by the last Congress, an investigation and study of the Interstate Commerce Commission was ordered to determine what changes could be made to promote maximum efficiency in that regulatory agency. An engineering survey is under way now to determine how to streamline the work of that body. Other proposals by the Transportation Association of America are to: authorize carriers to increase rates if the Interstate Commerce Commission does not act within thirty days on general rate increase proposals; repeal the "Rule of Rate Making"; reduce the suspension period from seven months to three months; authorize the Interstate Commerce Commission to increase intrastate rates if state commissions do not act within forty-five days.

Whether legislation is the answer is questioned by some because of the length of time necessary to procure the desired laws.

SOME state commissions, including ours, have sought to establish rates which give recognition to what is sometimes called attrition, slippage, or deterioration in the rate of return.[10] When a rate of return is found and determined to be fair and reasonable, based on the figures developed for a test period, such commissions, realizing that utilities in the past actually have not experienced that rate of return, due to increasing capital investments to meet their enlarging customer demands, and increasing expenses, have made an allowance for that attrition by adding various fractional percentage points in the return. By this method, at least some if not all of the deterioration in the return which otherwise would occur has been prevented and the utility can be assured of a return that truly is fair and reasonable and sufficient to permit the utility to meet its obligations and its customer needs, finance itself satisfactorily, and have a reasonable amount left over for addition to surplus.

This is the end to which all are striving. To that end all available and to be attained techniques should be directed so that utilities may be in a healthy condition and the public adequately served.

[9] Arizona, Arkansas, Colorado, Connecticut, Delaware, District of Columbia, Florida, Idaho, Illinois, Kansas, Kentucky, Maine, Maryland, Missouri, Nevada, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming.

[10] See PUBLIC UTILITIES FORTNIGHTLY, Vol. XLIX, June 19, 1952, page 875.

APPENDIX

The Regulatory Lag and Rail Rates

By E. H. BURGESS*

JUSTICE delayed is good neither for lawyers nor the parties involved. It is for that reason that we are here to consider a delay in the regulatory system for utilities that is an outstanding fact of serious public concern.

Regulation by the public of enterprises that are private has had a long history and a purpose that are well understood. From time immemorial the body politic has progressively regulated those businesses, like transportation and others, whose operations directly affect the well-being of the community at large. The reason has been a general recognition that conformance by such enterprises to prescribed regulations is required for the protection and promotion of the common good. But at the same time there has inhered in the acceptance of regulation as a social requisite, the companion and equal idea that the end objective of regulatory justice by administrative tribunals, like that of the judiciary, is protection of the rights of the individual.

So it is that there is growing concern because the regulatory system of today, by reason of its delays, is falling seriously short of protecting these rights. These delays constitute and are styled the regulatory lag. And by that is meant the costly extent to which this system now delays necessary rate relief for carriers already burdened with the rapidly rising operating costs of recent years. Without any intent to minimize the seriousness to other utilities of regulatory lags, what I say will relate primarily to the inordinate effect of such lags in the field of rail transportation.

IT is, I think, most pertinent and timely that this subject receive the thoughtful consideration not only of the bar but of legislators and the public generally. There is need today for examination of our regulatory system in action; for consideration of what it is and how well it serves its great purpose. There is need to see how railroad regulation in particular, born as it was in an economic environment in which railroads monopolized the transportation field, affects the public interest of today by its effect upon the railways in their modern environment of keenest competition with all the other agencies of transport now in operation.

While not always true, end results of regulatory as well as other means are a fairly reliable test of the means. A regulatory system, or a deficiency in it, assumes importance not only in proportion that the activity regulated is essential to the common good, but in proportion also that the end results of the regulation contribute most to that good.

In making this examination, there is need to realize at the outset that rail service in this country is now, and for the foreseeable future will continue to be, unexpendable. To a progressive body politic, healthy arteries of rail transportation are as indispensable as healthy arteries of circulation to the physical body. No one informed of the facts will doubt that for the well-being of the civilian economy and for the success of the nation's enforced defense rôle, the kind of transportation that can only be furnished by the steel wheel on the steel rail must be kept adequate. It must operate with equal regard for the public service and its own economic soundness.

SINCE the depression of the early thirties and particularly since World War II, there can be little room to doubt that the system's procedures have been too ponderous to serve properly the public interest. In the four postwar general rate increase cases necessitated by the rapid inflation of wages and prices, the time consumed by the procedures between filing each request and securing final relief averaged about nine months, although in each a limited interim increase was authorized within less time.

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Moreover, with the exception of the request in the most recent of these proceedings, known as Ex Parte 175, the full amount deemed necessary by management, and sought by management, was not granted in any case. The real significance of this lies not only in the damaging loss during the time lag, but in the fact that the full increase requested, if promptly granted, would not in any instance have yielded the carriers as a whole as much as a 6 per cent return on net investment.

In this connection a review of the procedure in the Ex Parte 175 general rate increase case may well illustrate the regulatory system in its best action. It is not only the most recent of such proceedings but one in which every possible expedition was strongly urged, particularly by the petitioning carriers. The case was begun on January 16, 1951, by a petition to the Interstate Commerce Commission for a nation-wide increase in freight rates approximating 6 per cent. The petition set forth that due to wage increases authorized under the processes of the Railway Labor Act and increases in prices of materials and supplies then in effect, the annual cost of producing rail transportation had increased by $421,000,000 over and above the annual cost at the time the then existing rate levels had been authorized. Since rate increases, even when granted, cannot be made retroactive to recoup carriers for loss on past service, the burden of an additional $421,000,000 of annual expenses without offsetting rate relief, meant an irreparable loss until relief could be secured.

UNDER the compulsion of these circumstances, and in an effort to minimize the loss, the carriers on the third day following the filing of the petition made a formal motion, upon affidavits showing the increased costs and resulting inadequacy of earnings. They asked the commission to allow the 6 per cent increase to become effective at once, but subject to full hearings and investigation thereafter, and with a stipulation and commitment by the carriers that they would promptly honor any claims for reparation to the extent that increases ultimately authorized by the commission following its investigation might be less than the interim increases of 6 per cent.

Apart from this express stipulation, it has long been a feature of the regulatory law that the commission may award reparation to protect a shipper who has paid rates unreasonably high for past service. There is, however, no counterpart provision for similar protection of a carrier which has rendered transportation at rates later found to be unreasonably low. It was in an effort to bridge this deficiency and as far as possible safeguard the carriers against a lag loss without injury to shippers, that the motion for interim effectiveness of the 6 per cent increase was made.

The motion was not granted, and the case was set for hearing and oral argument. After that an interim increase approximating 2.4 per cent, or, roundly $207,000,000 annually, in gross revenues for the country as a whole was authorized and became effective April 4, 1951.

THUS, although having earned only 3.9 per cent on net investment in 1950, and burdened in 1951 with an increase of $421,000,000 in operating costs, no relief was available until two and one-half months later, and then only to the extent of less than half of the cost increase, or 2.4 per cent instead of 6 per cent.

By the time this partial relief was allowed, further wage increases under the processes of the Railway Labor Act and price increases had become effective, thereby more than doubling the $421,000,000 annual increase in operating costs to roundly $973,000,000. Confronted as they then were with such a major additional cost increase and the manifest inadequacy of the interim relief of 2.4 per cent, no alternative seemed open but to file an amended petition, as was immediately done on March 28, 1951, for an increase of 15 per cent in lieu of the 6 per cent previously sought. Extended hearings, briefs, and oral argument followed on the 15 per cent petition, and

four months later, on August 2, 1951, an average nation-wide increase approximating 6.6 per cent, including the prior interim increase of 2.4 per cent, was authorized, to become effective not earlier than fifteen days thereafter. In a press release accompanying its decision, the commission estimated that this authorization should increase the carriers' gross freight revenues annually by $548,000,000.

THE situation then was that although increased costs at the annual rate of $973,000,000 were already being incurred by the carriers in March, 1951, when the 15 per cent petition was filed, no relief excepting the interim 2.4 per cent, was available until near the end of August, when it was allowed to the extent of little more than half the cost increase, or 6.6 per cent instead of the requested 15 per cent.

These circumstances were very disappointing and disturbing to the carriers, and on October 19, 1951, they petitioned the commission for further consideration. Extended additional hearings began on January 14, 1952, followed by the submission of further briefs and a week of oral argument, ending February 29, 1952.

On April 11, 1952, the commission in its final decision authorized substantially the full 15 per cent increase which had been requested over a year previously in the petition of March, 1951. The new rates became effective May 2, 1952, which was as soon as they could be published—approximately fifteen months after being requested and after incurring the cost rises justifying them.

THE procedure in this case has been delineated in this detail, not as criticism of the commission, but because, in the absence of some even more compelling emergency, it is believed to represent as prompt action in a general revenue case as may be expected under the regulatory system as it now exists. It is not to be denied that the commission faces a heavy burden in hearing and deciding proceedings of this magnitude and complexity under prevailing procedures. It is recognized too that in dealing with this case the commission did make special effort under special rules to expedite its disposition in various ways. The fact remains, however, that notwithstanding all that was done in that behalf, the case exemplifies a procedure that had the effect of requiring the railways of the country, in a period of unprecedented general business activity and high earnings by other industry, to render service a year and three months at rates that were inadequate by a wide margin.

Enforced service for long periods at rates subsequently found too low cannot be otherwise than seriously devitalizing to any enterprise, and is no less so to the sound economic status of carriers upon which must depend the adequacy of their service.

BUT detrimental lags in rate relief are not confined to the interstate field. The constitutional demarcation between interstate and intrastate commerce has the effect of dividing the regulatory system applicable to rail carriers and other interstate utilities into many parts between national and state tribunals. Thus, after incurring such lags as now seem inherent in securing from the Interstate Commerce Commission the measure of relief it may grant in interstate rates, the necessity for application to each of the state commissions for corresponding relief as to intrastate rates multiplies the lags.

While many of the state tribunals, I am happy to say, have acted with gratifying expedition in approving the interstate levels, substantial and costly additional lags in other state action have all too often been encountered. Indeed, in some states, general increases authorized in interstate rates by the Interstate Commerce Commission several years ago, are still not in effect. These situations may, it is true, be regarded as extreme cases, but they illustrate not only the potentialities but the injurious actualities in the existing system.

Serious as it may be for any industry, lagging price relief must be proportion-

ately more serious for a utility, like the railways, whose earnings over the years have been so notably low when seen alongside those of all other industry. During the postwar years of extraordinary peacetime traffic and high industrial earnings generally, the railroad average on its depreciated investment was a rate of return ranging from 2.75 per cent in 1946 to a high of 4.24 per cent in 1948. Back in the decade of the twenties the average was about 4 per cent, in the thirties slightly above 2 per cent, and even during the unprecedented war years less than 5 per cent.

In a painstaking study by Professor Sidney Miller and associates, entitled "Rates of Return—Class I Railways 1921-48," published by the University of Pittsburgh, the poor comparison of railway earnings with those of other enterprises is statistically and impressively established. It was also of record in Ex Parte 175 that in the postwar years the rate of return of the principal utilities, other than railroads, ranged between 5½ per cent and 7 per cent, with more than that for unregulated industry, in contrast with a depression level of about 3½ per cent for railways.

As might be expected, long prevalence of subnormal earnings has taken its tolls and had its effects on the industry's economic soundness and consequent ability to serve. The impairment of the industry's credit by meager returns to its stockholders compared with those afforded investors by other enterprises, has been a high toll. For years no new equity capital worthy of mention has come into the industry, although a heavy and unbroken inflow of venture capital is a continuous requisite, without which the success of no private enterprise may long be reasonably expected.

Another toll is a heavy increase in railway short-term debt. Low earnings have not lessened in any degree the very proper demand for modernized equipment and better service, both by the public to meet civilian need and by the agencies of government for defense purposes. To satisfy the pressure of this demand as well as has been done, short-term borrowing for new equipment necessarily purchased on the instalment plan through equipment trusts and conditional sales agreements, increased threefold—from $773,000,000 in 1945 to about $2.5 billion today. Annual payments on these obligations now aggregate close to $300,000,000.

A disturbing further consequence of low earnings is that capital improvements, other than equipment, have necessitated the invasion of working capital, until at the end of 1951 it stood at less than one-third its amount at the end of the war. Still other natural results of the revenue deficiency, as stated by the commission in its report in Ex Parte 175, have been a billion-dollar deferment of maintenance and a decline in the ratio of current assets to current liabilities from 2.21 to 1.6 between the year ends of 1946 and 1951. This deterioration in current position, the commission said, was "most serious."

Revenue inadequacies of this nature and duration naturally pose the question: How long in such circumstances can private management continue to provide the ever improved service civilian and national welfare demand? I raise this question and mention this economic status of the industry because it is that status that proportionately increases the damaging effect of a regulatory lag.

The economic erosion of delayed rate relief is surprising in its magnitude. It was established in the record in Ex Parte 175 that if the revenue increases sought to meet rising operating costs in the five postwar years 1946-50 had been allowed to become effective within thirty days after being requested, and retained to the extent of 84 per cent, net railway operating income of the carriers would have been greater than it was by $1,949,000,000 for the period, or by $390,000,000 in each of those years. The reasonableness of the full requests is well indicated, because with them the rate of return on net investment would have averaged only 5.15 per cent, instead of 3.51 per cent as it actually did in those years.

It also appeared that if the increases which the commission ultimately did approve during that period had been made effective within thirty days after being requested, and retained to the same extent, there would have been an increase in net railway operating income for the period of $601,000,000, or $120,000,000 each year. In other words, during the time it took the procedure to make available the relief which it ultimately did provide, the carriers lost net railway operating income at the rate of $120,000,000 a year. The carriers earned on their net investment during the lag period only 3.51 per cent, and would have earned only 4.02 per cent if the relief ultimately allowed had been made available more promptly.

The quick adjustment of prices by unregulated private enterprises to cover rising operating costs is accepted as commonplace business prudence and as socially right and proper. Without such adjustments satisfaction of the profit motive as the touchstone of all private enterprise would soon be defeated. So common are prompt price changes by unregulated business that even during periods of general price control, price increases to compensate wage increases, are allowed either concurrently with or but shortly after the wage rise. There is no substantial lag in price relief, as the recent wage and price adjustments in the steel industry well exemplify. Economic law and the public interest now call for a regulatory system that will accord similar price relief to business that is regulated.

Delayed relief cannot of course be assumed to be the sole cause of thin railroad earnings, but it is a major cause. It is a defect in the regulatory system that has come to constitute an unreasonable burden on interstate commerce. It is a burden alike to the carriers bound to render service and unable voluntarily to discontinue it, and a burden no less to the public interest in rail service. Whatever impairs the stability and adequacy of that service, as does the regulatory lag, is not only inimical to the public welfare, but in its private aspects exemplifies *pro tanto* the old principle that justice delayed is justice denied.

Remedy

In searching for a remedy for this situation, it is well to remember that the end objective of regulation is not static, but, as experience teaches, is as dynamic as the changing concepts of what is socially desirable.

In the railway monopoly period before 1920, the customary regulatory procedures worked with less serious hardship than they do today. Increased-rate hearings were less time consuming; the design of regulation then was restrictive in purpose to guard against excessive rates, and time lags in cutting them down were not serious because the public was protected by reparation during any delay.

But in 1920 a changed concept of what was necessary to protect the common good came into the law. Mere restrictive regulation was no longer enough. The Transportation Act of that year, as the Supreme Court said in the Dayton-Goose Creek Case (263 US 456, 478),

> Seeks affirmatively to build up a system of railroads prepared to handle promptly all the interstate traffic of the country. It aims to give the owners of the railways an opportunity to earn enough to maintain their properties and equipment in such a state of efficiency that they can carry well this burden. To achieve this great purpose, it puts the railroad systems of the country more completely than ever under the fostering guardianship and control of the commission.

Especially pertinent to the problem of remedying the regulatory lag is the court's emphasis that the great purpose of the changed regulatory concept was a "fostering guardianship" designed "affirmatively to build up a system of railroads" to a state of adequacy to the country's needs, and to give the owners of the railways "an opportunity" for adequate earnings.

Although the recapture clause, whose

legality was the issue in the Dayton-Goose Creek Case, was later repealed, the philosophy of the court's pronouncement has not been changed. Instead, it was carried forward and reaffirmed by the Congress when, in 1940, it wrote into the Interstate Commerce Act the existing declaration of "National Transportation Policy." Among the parts of this national policy pertinent particularly to the problem of the regulatory lag, is the congressional declaration that regulation shall be "fair and impartial," and "so administered as . . . to promote . . . adequate, economical, and efficient service and foster sound economic conditions in transportation and among the several carriers."

Under such a policy and court pronouncement, the questions are: Can a regulatory system be "fair" if the relief it affords lags, with its resulting loss, behind need to the extent it now does? Can it be said that a regulatory system promotes "adequate, economical, and efficient service" or "fosters sound economic conditions in transportation" when there is inherent in it substantial delays in relief during which the economic strength of the carriers is irretrievably sapped? Are such lags consistent with the "fostering guardianship" or "the opportunity to earn" sufficient revenues which the court found to be the new purpose of regulation? These questions must, it seems, be answered in the negative.

Relief from the lag disability in this system to be effective, it seems to me, needs to take the form of a change in the system to the extent of eliminating by law the opportunity for unnecessary delay. Such a change is the proper office of a remedial statute. Statutes conventionally have as their prime purpose the remedying of some defect in the law as it has developed, and its adaptation to the changes of time and circumstances.

It can well be doubted that effective remedy can be accomplished by rule change, or other means short of express statutory sanction. Present relief procedure with its inherent and devastating delays, by long practice and precedent and by the commission's obedience to what it now deems procedural, if not substantive due process, has become too crystallized, I fear, to justify expectation of satisfactory correction short of statutory authority.

At least three directly interested, large, and responsible groups have proposed significant statutory remedies, believing that in legislation lies the only effective relief. In them all is a common recognition that, in the public interest in adequate service, carriers must have a way to effectuate more promptly the rate changes that rising costs require.

The first of these remedies is contained in a bill, known as S 2518, introduced in the last Congress and made the subject of extended hearings in which it was supported by the railroad industry. Adjournment prevented a committee report or final action, and the bill will doubtless again be introduced in the new Congress. It provides simply that when carriers incur increased operating costs impairing their ability to provide adequate service, they may, upon certification of that fact to the commission, make corresponding rate changes effective not less than thirty days thereafter. The increases would become effective without suspension but, either upon complaint by any citizen or upon the commission's own motion, would be subject thereafter to such adjustments as the commission should find in order. In substance, the present practice of long nation-wide investigation before relief, with its intolerable carrier injury, is changed to investigation after effectiveness, with injury to no one.

Similar in basic principle is the statutory remedy recommended by the executive committee of the National Industrial Traffic League, an organization, representing thousands of shippers and industrial organizations throughout the country. Under this plan, upon like certification to the commission by carriers of increased operating costs, the commission would be required, within thirty days, to authorize certain increases. They would satisfy the specified standard of provid-

ing "revenues sufficient to enable the carriers to provide adequate and sufficient service, maintain sound credit, and attract equity capital." Rates thus made effective on an interim basis would be subject to full investigation thereafter by the commission, with authority to make modifications and reparation awards if found necessary.

THE third remedy to which attention is directed was recommended recently by the National Co-operative Project on Transportation Policy. The project is an organization of panels or groups, each representing a separate form of transportation as well as the users of and the investors in all transport. It was set up in 1947 by the Transportation Association of America to study transportation problems with a view to recommending, as far as possible, uniform corrective measures in the interest of adequate service.

The project's plan to correct the regulatory lag, although not yet approved by the association, calls likewise for a statutory amendment. It would permit carriers, upon incurring substantial cost increases, to give notice to the Interstate Commerce Commission of intention to make a corresponding rate increase. Within thirty days the commission would be empowered to revise the proposal if it found, preliminarily, that the carriers' estimates of cost increases were erroneous, or that the intended rate increases were too high, or were not properly spread over all traffic. But if no revision upon such *ad interim* findings were ordered within the thirty days, the proposed rates would automatically become effective, but still subject — and here again is the safeguard—to full hearing and modification, including reparation, if found in order by the commission.

OF these remedies, the one contemplated in S 2518 is believed best adapted to the effective solution of the lag problem. It contemplates the effectiveness of general rate changes without prior commission action, while the other plans provide for some commission action before effectiveness. Since in the nature of the situation and the 30-day time limit any prior action would at best be but superficial, and since full investigation by the commission is to follow in any event, it is not apparent that superficial prior action is needed or would serve any useful purpose.

While for the reasons stated S 2518 seems the most appropriate remedy, real constructive headway has been made by the extent to which the responsible sponsors of these plans recognize the principle that rate changes to meet rising costs must, under existing conditions, be allowed to go into effect more promptly, with necessary investigation and revision afterward. Upon that foundation and through some combination of these plans or otherwise, an effective statutory remedy may be expected.

THE public's natural apprehension that excessive rates would thereby be initially established is more apparent than real. In the prior era of railroad monopoly in the field of transport, that fear had substance, and the public interest then required and the regulatory system provided restraints to guard against that eventuality. In today's intense competition with all the new agencies of transport that have come rapidly into successful operation, railroads know full well that their own self-interests and ability to compete would hardly be served by rate rises out of line with those of their vigorous competitors. If on occasion excessive rates did go into effect initially, public protection would lie in the investigation that would follow, with all the correcting adjustments and reparation the commission found proper.

The great virtue of these plans is that the public is safeguarded against excessive rates not only by the controlling power of competition, which is deemed a sufficient price protector in other segments of the economy, but also by the commission's unhampered powers of subsequent investigation. At the same time and of equal importance to the public interest, the carriers are protected against

a socially unnecessary and irretrievable lag loss.

PROCEDURAL lags at the state level, although equally serious in their cumulative effect, have, it is submitted, even less justification. State action on general rate increases follows the Interstate Commerce Commission's action in which representatives of state commissions customarily and actively participate, not only as hearing commissioners, but as stout advocates of state interests. On this account it would seem but reasonable that consistent state action should promptly follow Federal action.

Since the well-being of interstate commerce depends upon a proper revenue contribution from intrastate commerce, the power of Congress in the premises is clear. That power has long been exercised through the authority given the Interstate Commerce Commission in § 13 of the Commerce Act to revise state action to bring state rates in line with its prescription of interstate rates. There is, however, no time limit upon state action, and therein lies the lag. What is reasonably needed is a reasonable time limit of approximately forty-five days to stimulate tardy state tribunals to take action.

The finest tradition of our law is its capacity in changing circumstances to "produce common-sense justice." It is that tradition and that kind of justice that now call for an end to the regulatory lag.

Titles and Index

Preprints in This Issue of Cases to Appear in
PUBLIC UTILITIES REPORTS

TITLES

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Re Eastern Massachusetts Street Railway Company

D.P.U. 9750
July 30, 1952

INVESTIGATION *as to propriety of rates and charges filed by transit company; approved with modifications.*

Return, § 28 — Support of security prices.

1. The Commission need not require the public to furnish a transit company with earnings necessary to support the market for its oustanding equity securities where the company's surplus deficit is almost equal to the par value of the securities, since it is apparent that none of the equity money invested in the enterprise is represented by property used and useful in the public service, p. 35.

Return, § 26 — Cost of money — Securities representing abandoned property.

2. The Commission need give little attention to evidence as to cost of money and rate of return on equity securities of a transit company which has a surplus deficit almost equal to the par value of the equity securities and where the equity securities are mainly representative of money spent to acquire already abandoned street railway property, p. 35.

Valuation, § 202 — Obsolete and abandoned properties in rate base — Transit.

3. The obsolete and abandoned properties of a transit company which has converted from street railway to motor carrier operation need not be considered in determining the company's rate base, p. 35.

Valuation, § 316 — Working capital allowance — Transit company.

4. No working capital allowance will be allowed in a transit company's rate base, p. 37.

Return, § 16 — Need for transit company — Operating ratio.

5. It is absolutely necessary that a transit company maintain a sound operating ratio, p. 39.

Return, § 24 — Maintenance of profit margin.

6. A transit company whose operations are volatile must maintain a margin between income and expense in order to maintain its financial position so that future fluctuations will not result in its carrying on business at a loss, p. 39.

Return, § 108.1 — Transit operating ratio.

7. An operating ratio of 95.08 per cent was not considered in excess of a safe margin for a transit company, p. 39.

APPEARANCES: Charles W. Mulcahy, General Counsel, J. Joseph Maloney, Associate General Counsel, for Eastern Massachusetts Street Rail-

way Company; P. Harold Ready, City Solicitor, for city of Lowell; Albert Cole, Assistant City Solicitor, for city of Lynn; James P. Kane, City Solicitor, for city of Lawrence; James J. Bradley, City Solicitor, for city of Salem; William B. Sullivan, Jr., Town Counsel, for town of Danvers; Douglas Randall, Assistant City Solicitor, for city of Quincy.

By the DEPARTMENT: Eastern Massachusetts Street Railway Company filed on October 11, 1951, new schedules of rates and charges for transportation of passengers stated therein to be effective November 11, 1951. The operation of these schedules was suspended by the Department and public hearings were held in Boston in an investigation ordered in connection therewith on November 26th and 27th and December 12th and 27th. Due public notice of the fare changes was posted in accordance with our rules.

Respondent provides local and interurban bus service in and between more than seventy different communities in eastern Massachusetts, extending from Haverhill on the north to Fall River on the south of Boston. No local service is performed in Boston, but several of its lines from the north run into Haymarket Square, its Fall River line runs into Park Square, and several other of its lines terminate at rapid transit terminals of the M.T.A. system serving Boston.

The present basic fare throughout respondent's system is 10 cents. It provides tokens, at three for 25 cents, good within token zones which, for the most part, are somewhat shorter than the zones for cash fares. It also offers a weekly ticket between certain points, good for twenty-four rides at a price of $1.50. These rates and zones are subject to very many exceptions, and there are numerous special tickets. Respondent proposes a general rearrangement of its fare zones, making the token zones generally co-extensive with the cash zones, and proposes to increase the basic fare to 15 cents, the token fare to two for 25 cents, and the price of the weekly ticket to $2.25.

The basic principle which respondent has applied in its zoning rearrangement beyond the first fare limit is to mark off a first zone of 2½ miles, and to provide for an additional fare increment of 5 cents for each 1½ miles thereafter. Because this formula is being applied to respondent's lines for the first time, it is impossible to generalize as to the percentage of the increase on longer runs. Some of the resulting increases are, as hereinafter noted, so heavy as to require some modification; others remain unchanged or else are affected relatively little. Respondent also proposes to institute a new variety of 10-trip commutation tickets on trips where the basic fare is 35 cents or over, good for ninety days after issuance, at a price equal to ten times the basic fare. Under present rulings of the Treasury Department, such tickets will not be subject to tax, and the purchaser will save the tax, i.e., 15 per cent, on the cost of such tickets. Although we are aware of the dangers inherent in making comparisons of this nature, it is a fact that the rates so proposed by respondent for interurban travel compare favorably with those charged by other bus companies in the state for travel over comparable distances.

Respondent was organized in 1918 (Special Acts of 1918, Chap 188) for the purpose of acquiring the properties of the Bay State Street Railway, then in receivership. Under its charter, it was to issue securities in an amount based upon a valuation of its properties made by the predecessor of this Department. Its original capitalization was in the amount of $47,967,182.39, which was later written down to $41,401,825.72, which latter amount was the value as found by us at that time. Under Special Acts of 1918, Chap 188, respondent's affairs were placed in the hands of public trustees who maintained such control under various extensions of the original act until January 15, 1949. On that date, due to the failure of respondent to accept the provisions of Acts of 1948, Chap 558, the public trusteeship was terminated and, for the first time since 1918, this carrier became subject to the jurisdiction and control of this Department as a Street Railway under G.L. Chap 161. Before this happened, however, and while it was still under public control in July, 1948, respondent placed new tariffs in effect substantially increasing its fares.

[1–3] By the time that respondent came under our jurisdiction, it had abandoned all of the trolley car operations, the equipment for which had been in very large measure responsible for the substantial valuation placed on its properties in 1918. Its trustees had been authorized by its charter to make provision for "losses in respect to property sold, destroyed, or abandoned as they" might deem adequate, or as we might require. Neither was, in fact, done, and respondent's balance sheet as of September 30, 1951, which was substantially that shown at the time of termination of public control, may be summarized as shown on next page.

The decrease in outstanding securities since 1918 is largely due to retirements of bonds by purchase at substantial discounts. At the present time, except for the $3,635,000 of long-term debt, all of the outstanding securities of respondent are, strictly speaking, equity securities. But the surplus deficit is almost exactly equal to the par value of such equity securities. The only conclusion we can draw from this situation is that there now remains substantially no equity money invested in this enterprise represented by property used and useful in the public service. We do not believe we are called on or that we should consider that the public must furnish respondent with the earnings necessary to support the market for these equity securities. We think this is a classic case demonstrating the frailities of the rules laid down in the Hope Natural Gas Co. Case (1944) 320 US 591, 88 L ed 333, 51 PUR NS 193, 64 S Ct 281, to which so much attention has been paid. Respondent's investors have sunk millions of dollars in street railway equipment, which has been made obsolete by developments in the art which could not have been foreseen. We do not believe that the law compels us to see that the investment which these people made is kept inviolate regardless of inventive and social changes. The investor in public utility securities, when he puts his money into these securities, trades the possibility of increased earnings for the stability traditionally associated with regulated

Assets

Current Assets		$890,350.94
Carrier operating property	$13,414,509.83	
Less accrued depreciation	8,828,148.43	
Net operating property	4,586,361.40	
Non-operating property (net)	488,007.44	
		5,074,368.84
Prepayments and Deferred Items		288,126.84
Total Assets		6,252,846.62

Liabilities

Current liabilities		788,125.24
Funded debt:		
General Mortgage Bonds	3,335,000.00	
2½% Note due 9/1/52	300,000.00	
Equipment notes	725,991.00	
		4,360,991.00
Reserves (except depreciation)		965,558.33
Capital Stock (net)		
Preferred, Series A	3,049,278.34	
Preferred, Series B	2,117,800.00	
Adjustment	6,460,045.89	
Common	6,230,882.74	
Total capital stock		17,858,006.97
Surplus (deficit)		(17,719,834.92)
Total liabilities		$6,252,846.62

enterprises. He does not expect, or at least we do not believe he is entitled to receive insurance against the danger that progress will make obsolete the equipment which his money was used to purchase. It is well settled that such obsolete and abandoned properties are not to be considered in determining the proper rate base upon which to compute a rate of return. Baker v. Public Utilities Commission (DC DC) June 13, 1950, reversing Re Washington Gas Light Co. (DC 1949) 83 PUR NS 4; Georgia R. & Power Co. v. Railroad Commission (DC Ga 1924) PUR1925A 546; Re Blue Hill Street R. Co. (Mass) PUR1915E 370. See Re Western Massachusetts Electric Co. (1951) D.P.U. 9658. We indicated in the original Bay State Rate Case (Mass) PUR1916F 221, in which the value of respondent's property was established, that obsolete horse-car property held on the books for twenty years should be deducted from its original investment for purpose of valuation. It has been more than twenty years since its street railway properties became substantially obsolete, in turn. There is no evidence, and we do not believe that the decision of respondent to motorize its operations and abandon its streetcar facilities was dictated solely by an altruistic desire better to serve the public, and we do not believe the holding in Pacific Gas & E. Co. v. San Francisco, 265 US 403, 68 L ed 1075, PUR1924D 817, 44 S Ct 537, is applicable to the facts in this case. We believe that it would be a remarkable proposition that we should refuse to include such obsolete property for rate base purposes, but should

include among the securities upon which the respondent must be allowed to earn income, the equity funds used to acquire such property. Consequently, we believe we are required to give little attention to the impressive evidence here as to cost of money and rate of return on equity securities of transit companies.

[4] Respondent's balance sheet shows net operating property in the amount of $4,586,361. We have repeatedly held that we will not allow for purposes of establishing a rate base an increment over net operating property of a bus company on account of working capital. Re Springfield Street R. Co. (1951) D.P.U. 9514; Re Berkshire Street R. Co. (1951) 88 PUR NS 21; Re Massachusetts Northeastern Transp. Co. (1950) 86 PUR NS 192; Re Worcester Street R. Co. D.P.U. 8945, July 31, 1950. We see no reason to modify these previous opinions on the instant record. We hold and find, therefore, that respondent has prudently invested in property, used and useful in the public service, the amount of $4,586,361 upon which we are required to allow it to earn a fair return.

For the year ending December 31, 1950, respondent's operations resulted in a net profit of $723,192 before amortization requirements. There is no doubt whatever but that such earnings were at least adequate. However, after correcting for work stoppages, respondent's gross passenger revenue for 1949 (from July 1st) fell off 14.57 per cent as compared with the similar period in 1948. This decline continued during 1950, which showed a loss of 11.39 per cent as compared with 1949, and up to the latest time available before the hearings, i.e., November 14, 1951, at which time there had accrued a further loss in passenger revenue of 8.25 per cent as compared with the similar figure in 1950. Operating results for 1948, 1949, 1950, and 1951 (two months estimated) are as follows:

	1948	1949	1950	1951
Total Operating Revenue	$15,440,671	$13,724,768	$12,480,344	$11,511,568
Total Operating Expense	13,674,685	12,494,357	11,144,898	11,279,480
Net Operating Revenue	1,765,986	1,230,411	1,335,446	232,088
Other Income	34,898	37,954	36,747	25,672
Gross Income	1,800,884	1,268,365	1,372,193	257,760
Interest, etc.	224,988	206,466	189,001	161,611
Net before Income Taxes	1,575,896	1,061,899	1,183,192	96,149
Provision for Income Taxes	600,000	475,000	460,000	5,000
Balance to Profit & Loss	$975,896	$586,899	$723,192	$91,149

The results for 1950 were ameliorated to a substantial extent by some nonrecurring items of insurance and reserves, in the absence of which the earnings for that year would have been considerably lower than is indicated.

Actual results for 1951, available since the hearing and including certain nonrecurring and nonoperating items, showed a balance transferable to profit and loss for the year 1951 of $139,009.

An analysis of these figures convinces us that respondent was successful over the years until last year in holding down its expenses while its riders were staying away in increasing numbers. This constant attrition of passenger revenues comes as no shock: the transit industry in Massachusetts generally has been enduring a similar tendency. (See, for example, Re Union Street R. Co. D.P.U. 9562, Oct. 26, 1951; Re Hudson Bus Lines, D.P.U. 9535, Sept. 14, 1951; Re Dedham & Needham Transit Co. [1951] D.P.U. 9515; Re Springfield Street R. Co. [1951] D.P.U. 9514), and the pattern is quite consistent with that prevailing in the industry throughout the nation. The total diminution in bus passengers in all cities in the United States for the nine months ended September 31, 1951, as compared with the similar period in 1950 was 6.72 per cent, which compares with respondent's experience of about 8.75 per cent.

Apparently, however, respondent has been unable any longer to cut the cloth of its service to fit the pattern of public demand. Its efforts to economize by diminution of service are met with violent opposition by the communities affected. See Re Eastern Massachusetts Street R. Co. (Lawrence) (1951) 90 PUR NS 150; Mayor and City Council of Lowell v. Eastern Massachusetts Street R. Co. D.P.U. 9439, June 1, 1951; Mayor of Fall River v. Eastern Massachusetts Street R. Co. (1950) 84 PUR NS 127. And we are currently faced with numerous similar complaints. At the same time, the cost of respondent of doing business is constantly increasing. State and Federal gasoline taxes effective in 1951 will increase its annual expenses by $115,200. An increase in the cost of tires, effective April, 1951, results in its paying currently about $60,000 a year over the rate effective in January, 1951. In forecasting its results for the year 1952, it has been obliged to include additional expense resulting from a firm offer which it has made to its employees of a wage increase of 13 cents an hour over the $1.55 base rate now in effect. The cost of parts as of September 30, 1951, averaged about 10.6 per cent above the cost of similar items in June, 1950.

Considering all these factors, and anticipating a further decline in passenger revenues under present rates of 8 per cent (which compares with an actual for January, 1952, of 9.1 per cent), respondent estimates that its operations for 1952 will end up with about the following results on the basis of existing fares:

Total Operating Revenue	$10,585,677
Total Operating Expense	11,620,963
Net Operating Revenue (Loss)	($1,035,286)
Other Income	25,158
Gross Income (Loss)	($1,010,128)
Interest, etc.	143,352
Net Loss	($1,153,480)

This is truly an alarming picture which faces this, the largest privately operated bus company in the state. There is no evidence of any mismanagement, nor of excessive overhead or expense. That the estimates are not materially inflated is evidenced by sworn testimony adduced in other proceedings since the hearings in this matter that operations during January, 1952, were conducted at a loss

of $65,322, and those for February, 1952, at a loss of $78,127. So far as we are able to judge from the record we have here before us, respondent is a helpless victim of the familiar (to us) squeeze between falling patronage and increasing expense. We conclude that respondent must have additional revenue from its fares, not only to enable it to pay a reasonable return on the money invested in its property, but fundamentally and primarily in order to enable it to pay its bills.

Respondent estimates that the fare increases proposed in the tariffs it has filed will, after allowing for diminution of passengers induced by the increased rates in accordance with the formula which we have applied on many occasions (see, for example, Re Springfield Street R. Co. [1951] D.P.U. 9514), result in additional gross annual revenues of $2,075,304, or an average over-all increase of about 19.98 per cent. Applying this estimate to the figures already outlined for 1952, it arrives at a net income transferable to profit and loss and after Federal income taxes of $504,824. This represents a gross income before interest of $634,221, or earnings of about 13.8 per cent on the net amount which we have found to have been invested in utility operating property.

[5–7] But this is not the whole story, for it leaves out of consideration an extremely important point of view, and one which we have from time to time emphasized. We feel we must inquire as to what the respondent's situation and its proposals mean in terms of operating ratios. In 1948, it operated at a ratio after taxes (which is the only realistic approach, since under the decided cases income taxes are just as much an expense as anything else) of 92.5 per cent. In 1949, this became 94.5 per cent, in 1950, 93.0 per cent and in 1951, about 98.02 per cent. For 1952, at existing rates, this ratio would rise to 109.78 per cent. If the increase is granted as proposed, it will be operating in 1952 at a ratio of 95.08 per cent.

There is a distinct difference, as we have implied in a number of previous bus cases, between electric, gas, water, railroad, or telephone utilities, on the one hand, and passenger bus utilities on the other. The following tabulation shows the difference in percentage of annual gross operating revenue to net utility operating plant as shown on the last filed return for some fairly typical utilities of the first group:

	(a) Annual Rev.	(b) Net Plant Invest.	% (a) to (b)
Boston Edison Co.	$74,246,324	$192,601,338	38.5
New England Tel. & Tel. Co.	190,854,071	396,524,061	48.1
Boston Consolidated Gas Co.	23,353,120	41,830,120	55.8
Dedham Water Co.	266,558	1,707,584	15.6
Boston & Maine R. R.	86,580,762	226,488,619	32.5

On the other hand, we have already found that respondent has net utility operating plant of only $4,586,361, as against annual gross revenues for 1951 of $11,290,114 or a ratio of about 246 per cent. To illustrate the effect of this phenomenon more graphically, Boston Edison had an operating ratio

in 1950 of 85.1 per cent. The telephone company had a similar figure of 85.9 per cent, and the Boston and Maine Railroad of 87.1 per cent. Respondent's comparable figure was, as we have stated, 93 per cent, and the figure for the transit industry in the United States was 95.1 per cent. In other words, a relatively small increase in costs or decrease in revenue would bring, as it has done, the respondent to the point where it is running at no profit, or at a loss, while a decrease of the same percentage would not so endanger the solvency of the other types of utilities. The susceptibility of bus operations to wide patronage swings and accordingly to wide variations in revenue is illustrated by respondent's own income figures for the past few years.

The investment of respondent or, for that matter, of any motor carrier is in short-lived property requiring a very substantial annual depreciation charge. Of total depreciation of $659,047 charged by respondent in 1950, $564,332 was assignable to busses, the very large bulk of which were being retired at an annual rate of 8 to 10 per cent. Such short-lived equipment comprises about 74.4 per cent of respondent's gross depreciable plant account. Hence, respondent's net investment might vary sharply from year to year, making the rate base as understood in the traditional concept unstable and unsatisfactory for use in rate-making proceedings which should have as nearly permanent results as possible.

The necessity for maintaining a sound utility operating ratio has been recognized, not only by this Department but also by the Interstate Commerce Commission (Re Middle West General Increases, I. & S. No. M 2723 [(1948) 48 MCC 541]; Re Investigation of Bus Fares, No. MC–C–550 [(1950) 52 MCC 332]), and has the backing of respectable authority in the courts. In County Board of Arlington v. United States (DC Va 1951) 101 F Supp 328, in upholding a decision of the Interstate Commerce Commission that an operating ratio of 95.6 per cent was not excessive, a 3-judge court, at p. 330, said:

"True, operational costs and income predominated in the determination. This was not a matter of choice for the Commission. It was dictated by the nature of the utility under consideration. In following this natural course the Commission manifested an understanding of the methods and modus operandi of the business. For local transportation by bus the principal, and sometimes the sole, capital investment is mobile units. But so severe is their rate of depreciation that the entire investment, if unreplenished, would rapidly disappear. Too, the units demand close, constant, and costly supervision, repair, and maintenance. The necessity for frequent replacements requires that operating cost be heavily and regularly charged to create and maintain a depreciation reserve. Consequently, operating costs are the thing—the first and prime consideration in the ascertainment of what must be collected for the service. In this kind of utility the investment of capital in fixed assets seldom approaches the amount invested in that form by those utilities requiring for their purposes such permanent items as land, buildings, plants, rights of way, tunnels, trackage, depots, wires,

poles, mains, reservoirs, or similar long-lived properties. Careful appraisement in the latter class of utilities of their capital assets, in order to fix a rate base, is imperative, but it is not so dominant an inquiry for a suburban bus company. . . .

"Accentuation of operating costs in a proper case is known as the operating ratio rule. It is the pattern followed by the Commission here and in many other appropriate instances. Actually it is not a departure from the conventional modes. It is simply a label designating the process of evaluating a service in the light of all relevant factors, but with especial emphasis on the element of operating expense when the nature of the service makes operating costs the foremost consideration."

The instructions in the Hope Natural Gas Case (1944) 320 US 591, 88 L ed 333, 51 PUR NS 193, 64 S Ct 281, go further than to direct us to allow respondent an income adequate to allow it to pay dividends on its outstanding securities, a proposition to which we are unwilling to subscribe in the case of the unusual balance sheet here before us. It also insists that the return to the utility must be sufficient to preserve the financial integrity of the enterprise. If it is to maintain its financial position, we believe and hold that a utility whose operations are as volatile as those of respondent must maintain a margin between income and expense sufficient so that tomorrow's fluctuation will not result in its carrying on business at a loss. Such a consideration has little to do with the question of the amount of the investment in utility operating plant, and is a function of the size of the income, not of the size of the investment.

As we have pointed out, respondent operated in 1948 to 1950 at operating ratios of from 92.5 per cent to 94.5 per cent. The average of Class I passenger motor carriers in the United States in 1950 was 95.1 per cent, and the average for 1946 to 1950 of these carriers was 92.5 per cent. Respondent proposes in these proceedings that its results for 1952, if we allow its increases to become effective, will be on an operating ratio of 95.08 per cent. We cannot say that an operating ratio of this order is so far in excess of a safe margin that we can safely insist upon substantial modifications of its proposals. We find that the over-all results sought by respondent in these proceedings are no more than are reasonable and proper.

We believe, however, that we must go further in this case and devote some attention to the effect of this proposal on individual cases. Respondent contemplates complete and immediate reform of its eccentric existing fare structure, and the results in some individual instances are such as to raise substantial doubts as to their fairness. The increase in average fares under respondent's proposal is from 11 cents to 15.28 cents, or about 39 per cent. By and large, the fares for the multitude of tickets offered by respondent are increased in somewhere near that proportion. In the case of the run from Park Square, Boston, to Fall River, however, respondent now offers multiride tickets between Boston and points south of Easton at substantially reduced rates which will be increased under its proposals by as much as 135 per cent. While the amount of rev-

enue involved does not loom very large in respondent's operating revenues, these increases will bear very heavily on the riders accustomed to use these particular tickets. We believe that respondent should offer a 46-ride ticket to and from Boston and Easton and points south of Easton, at a rate per trip based on 75 per cent of the base rate, under the same conditions as to use as the present multiride tickets. We believe, and so find, that the revenue effect of such change will be inconsiderable.

Due to the establishment of additional fare zones in Quincy, it is proposed that the existing 24-ride ticket will not be available between Quincy Square and Ashmont or Fields Corner. Upon analysis, it seems to us that the resulting increase to passengers, for example, from Hough's Neck to the M.T.A. system will be unduly burdensome. We will, therefore, order the proposed 24-ride ticket to be made available on the Quincy Square-Ashmont and Quincy Square-Fields Corner routes.

Since the time of the hearings in this case, and on March 10, 1952, respondent's employees, considering themselves to be aggrieved by the results of collective bargaining, declared a strike. See Re Eastern Massachusetts Street R. Co. (Fall River Division) (1952) D.P.U. 9965, 94 PUR NS 526. This stoppage was substantially complete and was effective until July 14th. As we pointed out in Re Middlesex & Boston Street R. Co. D.P.U. 10081, June 13, 1952, it is our experience and observation that the results of a contest of this nature upon the earnings and service of the carrier cannot help but be radical. On the other hand, it is much too soon for any actual current operating results to be available, or for the carrier finally to readjust its service to the present public need. Under these conditions, we believe it is proper to allow the schedules as modified in accordance with these findings to become effective for an interim period, prior to the expiration of which we believe respondent will be able to present a current picture on the basis of which we should be able to make a determination as to whether the new rates are just and equitable under the changed circumstances resulting from this catastrophic controversy.

For the foregoing reasons, after public hearings, investigation and consideration, it is hereby

Ordered: That M.D.P.U. No. 4 filed by Eastern Massachusetts Street Railway Company on October 11, 1951, to be effective November 11, 1951, be and the same is hereby approved, to become effective August 10, 1952, subject to the limitations hereinafter imposed; and it is *further*

Ordered: That M.D.P.U. No. 5 filed by Eastern Massachusetts Street Railway Company on October 11, 1951, to be effective November 11, 1951, be and the same is hereby disapproved; and it is *further*

Ordered: That Eastern Massachusetts Street Railway Company file with the Department a new and revised tariff to be denominated its M.D.P.U. No. 6, which shall become effective August 10, 1952, subject to the limitations hereinafter imposed, and which shall be identical in all respects with said M.D.P.U. No. 5, except that

(1) It shall contain provision for the issuance of 46-ride monthly com-

mutation tickets between Park Square and points on the Park Square-Fall River run from and including Easton to and including Fall River at a rate per ride which will be equivalent to 75 per cent of the new one-way fare between the stated termini.

(2) It shall extend the offer of Ticket No. 29 as described in M.D. P.U. No. 5 to the routes (a) between Quincy Square and Fields Corner and (b) between Quincy Square and Ashmont.

And it is *further*

Ordered: That such schedules shall continue and remain in effect until February 10, 1953, subject to further order of the Department, at which time, unless otherwise ordered, the rates of fare and schedules of charges in effect immediately prior to this order shall again become and be effective.

And it is *further*

Ordered: That, except as specifically otherwise stated herein, the Department's investigation in D.P.U. 9750 be and the same is hereby closed.

IDAHO PUBLIC UTILITIES COMMISSION

Re Boise Water Corporation

Case No. U-1025-1, Order No. 2146
June 24, 1952

APPLICATION *by water company for authority to increase rates; modified rate increase authorized.*

Valuation, § 48 — Rate base — Former base plus net additions.

1. A water company's valuation for rate-making purposes was determined by taking the valuation used by the Commission in a proceeding about twenty-five years earlier and adding net plant additions for each year from that date down to the end of the year preceding the present hearing, p. 44.

Valuation, § 250 — Customer contributions to plant.

2. Amounts paid by customers for plant extensions and construction are not properly a part of the rate base upon which a water company should earn a fair return, p. 45.

Valuation, § 319 — Working capital allowance — Water utility.

3. A water utility was allowed an amount for working capital that included its materials and supplies plus one-twelfth of its annual operating expenses, p. 45.

Return, § 26 — Cost of money — Allowance to provide surplus.

4. A water utility must earn more money than is required to meet the carrying charges of its outstanding securities, since it must have and maintain an adequate surplus which should be increased during times of rapid plant expansion and accelerated business activity so that bond interest and dividend payments are not passed in times of recission or depression, p. 47.

Return, § 115 — Water.

5. A water utility should be permitted to earn a return of 6.5 per cent on capital invested in plant facilities devoted to public service, p. 48.

By the COMMISSION: The above-entitled matter was brought before the Commission by the filing of an application by the Boise Water Corporation, for an increase in its rates and charges for furnishing water to the residents of Boise and vicinity.

The matter was set for hearing in the House Caucus Room, Statehouse, Boise, Idaho, at 10 A.M., Monday, March 3, 1952. After due and legal notice the hearing was held at this time and place before Commissioners H. N. Beamer, George R. Jones, and H. C. Allen, and the following appearances entered: Carey H. Nixon, Attorney at Law, Boise, appearing for the applicant; R. E. Edlefsen, Mayor, appearing for the city of Boise; R. E. Larsen, Utilities Auditor, appearing for the Commission; Stephen L. Guice, Secretary, appearing for the Commission.

After an opening statement by counsel for applicant, oral and documentary evidence was offered and received in support of, and in opposition to, the application. Whereupon, all parties had been given a chance to be heard, the record was closed and the matter was submitted to the entire Commission and taken under advisement.

Description of the Company

The Boise Water Corporation is the surviving corporation of one that began serving water to the city of Boise in 1891. The Boise Water Corporation was incorporated on April 2, 1928, under the laws of the state of Idaho to purchase the assets of the Boise Water Company. This corporation assumed control and the property was transferred on May 9, 1928.

The Boise Water Corporation obtains its water supply from fourteen wells that are equipped with deep well turbine pumps driven by electric motors. These wells are capable of delivering to the distribution system 15,000,000 gallons of water per day. Storage facilities consist of reservoirs of total capacity of 8,320,000 gallons, three are of concrete construction, one is of steel construction and one is of wooden construction. The distribution system consists of 180 miles of mains, 75 miles of which are 6 inches to 24 inches in size and the remainder being smaller than the 6-inch main. There is owned 14,304 meters and 13,963 active customers being served as of December 31, 1951, together with fire protection furnished to the city of Boise through 400 fire hydrants that are municipally owned.

Rate Base

[1] In Case F-503, Order No. 1022, dated May 13, 1926, PUR1926 D 321, the Public Utilities Commission of the state of Idaho, after extensive hearings, established a valuation for the Boise Water Company, the immediate predecessor company to the Boise Water Corporation.

In its order the Commission expressed the opinion that the value as found was an estimate of the cost of the property as it then existed, applying prices of labor and material as of the time of its construction, either

piecemeal or otherwise, under conditions and circumstances which existed at the time the property was constructed. The value found was not reproduction cost new, but was an attempt by the Commission to arrive at a value that was as near to the historical cost as possible. The records of the Boise Water Company were inadequate to produce the required information to establish the original cost or the historical cost.

In the matter here under consideration, we have used this valuation as a starting base in our approach to a reasonable rate base. We are of the opinion that this valuation of May 31, 1925, is the most reasonable and logical method of getting a starting base from which to determine the rate base. By starting with this base and adding thereto the net plant addition for each year from that date down to December 31, 1951, we will have a rate base that will be as near to the actual original cost of this property as can be determined. The construction work in progress has been accounted for on actual cost basis since the value was determined in 1925. The Commission has verified these amounts for plant additions taken from Exhibit No. 4 by actual check with the Work In Progress Ledger of the applicant. The staff examined the records, not only for the purpose of determining the accuracy of the figures shown in the annual reports, but also for the specific purpose of ascertaining the accuracy of the figures submitted in the application. It was found that the data shown on Exhibits 4 and 6 are reasonably supported. It can therefore be determined that the cost of the plant devoted to the public service of the Boise Water Corporation may be summarized as follows:

Commission Valuation, May 31, 1925	$1,080,183.00
Net Plant Additions 6/1/25 to 12/31/51	1,954,372.03
Utility Plant Investment, 12/31/51	$3,034,555.03

This figure represents the total gross investment in the water plant less the retirements that have been made, but to arrive at a rate base, we must determine the depreciation reserve that is to be deducted from this amount.

[2] In Case F-503, Order No. 1022, *supra*, found an amount for the depreciation reserve that was to be considered along with the plant value found in that case, it was determined that $278,438 was a reasonable amount to be included in the depreciation reserve account. Using the same approach as was used in arriving at the total investment for the applicant, it can be determined that $831,352.53 to be the amount of depreciation reserve to be deducted from the gross plant investment figures. There should be further deducted from the gross plant investment the amount of $13,559.52, this represents contributions for extensions. As these contributions represent amounts paid by customers and not by the applicant for plant extensions and constructions they are not properly a part of a rate base upon which a utility should earn a fair return.

[3] In the regular course of business a utility, such as a water company, must advance certain amounts of capital for working funds, this capital is in addition to that invested in the plant and property to furnish service to the

public. These funds must be included in the rate base and we term this working capital. It has been the practice of this Commission to allow an amount that includes the materials and supplies, plus one-twelfth of annual operating expense, this amount for 1951 for the applicant would amount to $46,354.99.

Upon consideration of the foregoing, we determine that the rate base upon which the applicant should be allowed a fair rate of return shall be calculated as follows:

Investment in Utility Plant	$3,034,555.03	
Plus Working Capital	46,354.99	$3,080,910.02
Less:		
Depreciation Reserve	$831,352.53	
Contributions for Extensions	13,559.52	$844,912.05
Rate Base, Dec. 31, 1951		$2,235,997.97

In our approach to the determination of a rate base it is not required that we take into consideration the sale of the property in 1928, or the Spooner & Merrill appraisal that was spread upon the books in 1929. This appraisal was a direct write-up of the plant accounts of this utility, and was carried in the plant accounts and in the general accounts from the time it was entered until finally adjusted at the end of 1941. We have not resorted to the general ledger accounts for plant investment in this proceeding, but have developed our information from the detail records where only actual costs of plant additions are carried. We have, however, determined that the accounts as now carried are in agreement with our conclusions herein, and the annual reports to this Commission are now, and have been since 1942, accurate in that they show the historical or original cost of this property as we have determined in this proceeding. We do not believe it necessary to review in this order the various adjustments that have been made on the general books of the applicant to eliminate the inflation that was included as a result of the Spooner & Merrill appraisal. We have in our determination by-passed any of these transactions by starting at a date subsequent to the actual appraisal and using only the actual costs that have been incurred in the addition to the plant by years since that date.

Revenue and Expenses

The record contains an explanation of the method and manner of computations and amounts of all items reflected in the revenue and expense accounts of the applicant. It has been determined by this Commission that the various subsidiaries of the applicant are charged all items of expenses that are incurred directly by such subsidiary. Expenses that are common to all companies are allocated on a time study basis, such study is made once each year and these expenses are then allocated on this basis. Transportation expense is charged on an hourly basis and based on the actual cost experienced with the vehicle. It is the opinion of this Commission that the expenses incurred by the applicant for the year 1951 were necessary in the normal operations of the business.

Rate of Return

The applicant has requested the approval of rates that will produce an additional $202,400 annually, the increase is spread over all the schedules of the presently filed tariffs uniformly. If these rates had been in effect during the year 1951, and all other operations had remained the same, then we would have had the following operating conditions:

Total Revenues		$636,630.00
Operating Expenses:		
Operations	$123,045.58	
Maintenance	27,449.62	
Depreciation	57,046.52	
Taxes	232,921.31	$440,463.03
Net Available for Return		$196,166.97

Applying the net available for return against the rate base as we have hereto determined it, it would produce a return of 8.77 per cent. There are certain other conditions that must be taken into consideration before we can determine what is a fair return on the rate base. That there will be certain increases in operating expenses can be projected with certainty, these include increases in the costs of labor, material, and power. Increased labor and material is anticipated to increase about 10 per cent, increased power costs due principally to additional pumping installations is expected to increase $7,700 so that the total increased expenses will increase $21,042 annually. Taking the increased expenses and the resulting saving on taxes, it is estimated that, under the proposed rates, the net income available for return would be $172,636 per year, this would produce a return of 7.72 per cent on the rate base.

During 1950, the Boise Water Corporation purchased securities of the Idaho Water Company, operating properties at Coeur d'Alene and Kellogg, Idaho, and the Oregon Water Corporation operating properties at Klamath Falls and Roseburg, Oregon. The Boise Water Corporation increased its own outstanding securities in order to obtain the necessary funds for the purchase of the securities of the above companies. These intercompany holdings now make it necessary to allocate between the various companies any calculation of a revenue requirement study that is made for the Boise Company.

The applicant's Exhibit No. 19 furnishes information as to the investment in securities of subsidiaries, the carrying charges of the outstanding securities of the Boise Water Corporation, and the allocation of these carrying charges between investments in subsidiaries and the Boise Water Corporation. This calculation is summarized as follows with the exception of a sinking-fund provision for the preferred stock:

	Interest	Sinking Fund	Total Requirements
First Mortgage Bonds—Series A 3¾%	$54,937.50	$23,010.00	$77,947.50
First Mortgage Bonds—Series B 3½%	87,920.00	38,250.00	126,170.00
Dividends on the 5% Pref. Stock			48,800.00
Dividends on Common Stock			50,000.00
Total Carrying Charges			$302,917.50

[4] As stated above, the total carrying charge must be allocated between the Boise Company and the other subsidiaries, this allocation results in 38.5

per cent going to the Boise Company, or $116,623.24. This would require a return of 5.22 per cent on the rate base. This would be the minimum return that the applicant could operate with, but if we were to allow only the minimum return on a rate base calculated as of December 31, 1951, then the applicant could not now earn such a return. It can be established from the record that there will be increased operating expenses and that the investment in utility plant is increasing every month so that we must allow a return that is considerably higher than the minimum as calculated above. The applicant [must], as must all companies, earn more than is required to meet the carrying charges of the outstanding securities. It must have and maintain an adequate surplus. This surplus should be increased during times of rapid plant expansion and accelerated business activity so that bond interest and dividend payments are not passed in times of recession or depression. But, with a public utility, the surplus should not be used for the declaration of stock dividends. It is the opinion of this Commission that the revenue requirement study should provide for additions to surplus and in this proceeding we will allow for these requirements as follows:

Debt Capital Requirements	$204,117.50
Preferred Stock Dividends	48,800.00
Common Stock Dividends	50,000.00
Assuming a 70% payout for dividends the surplus requirement would be	7,142.00
Total Requirements	$310,059.50

[5] Allocating this amount to the Boise Water Corporation and its subsidiaries on the same basis as used previously, then there must be allocated $119,373 to the Boise Water Corporation. This would be the minimum amount that is required to service the capital structure as of December 31, 1951, and would produce a return of 5.34 per cent on the rate base as it has been heretofore determined. For the applicant to earn 5.34 per cent on a rate base established for December 31, 1951, we must allow something in excess of this amount due to the continual additions that are being made. Taking into consideration the need for the future additional capital requirements for the further expansion of plant facilities, and the need for these additions, it is the Commission's opinion that the applicant should earn a return of 6 per cent on capital invested in plant facilities devoted to the public service. We have heretofore established our rate base as of December 31, 1951, since that time there has been additional investments in plant facilities made by the applicant and, if the applicant is to earn a return of 6 per cent on present investments, it is necessary that we allow a return of 6½ per cent on a rate base established for December 31, 1951.

The additional revenue required will then be calculated as follows:

Return earned for year ending December 21, 1951	4.50%
Additional return required based on 6.50% (6.50 — 4.50)	2.00%
Additional net earnings required (2.00% x $2,235,998)	$44,720
Additional gross earnings required ($44,720 ÷ .4534%)	$98,632

We therefore determine that the applicant should have increased rates that will produce an additional $98,632 of revenues per year.

From the foregoing, the Commission now finds:

I

That under Title 61, Idaho Code, as amended, this Commission has jurisdiction over the applicant.

II

That the Boise Water Corporation is a corporation, as defined in § 61–104, Idaho Code, organized under the laws of the state of Idaho with its principal place of business and post office address at Boise, Idaho.

III

That the Boise Water Corporation is entitled to earn on a rate base in the amount of $2,235,998. Said amount represents the original cost, as near as can be determined, of the property devoted to the furnishing of water service in Boise City, Idaho, in contiguous territory, plus working capital less the depreciation reserve and advances for extensions as of December 31, 1951.

IV

That a rate of return of 6.5 per cent on such rate base is required.

V

That the present rates do not produce sufficient revenues to produce such a return.

VI

That the Boise Water Corporation is entitled to an increase on its water rates and charges that will produce additional revenues of $98,632 annually.

ORDER

It is therefore *ordered* that the Boise Water Corporation submit tariffs for the Commission's approval that will increase revenues in the amount of $44,720 per year plus an additional amount of $53,912 for Federal and state income taxes.

It is *further ordered* that such tariffs shall become effective on billing dates subsequent to our approval thereof.

KENTUCKY PUBLIC SERVICE COMMISSION

Re H-F-C Rural Telephone Cooperative Corporation, Incorporated

Case No. 2347
July 15, 1952

APPLICATION *by telephone co-operative association for authority to acquire and operate telephone properties in the proposed service area of another telephone company; denied.*

Monopoly and competition, § 83 — Co-operative association and telephone company — Existing facilities.

A telephone co-operative association should be denied authority to acquire facilities of existing telephone companies and to operate in an area

which an existing telephone company is ready, willing, and able to serve within a reasonable time.

By the COMMISSION: On November 19, 1951, the H-F-C Rural Telephone Cooperative Corporation (hereinafter referred to as the "Cooperative") filed an application with the Commission wherein they sought the following authority:

(1) To acquire Beelerton Telephone Company, Cayce Telephone Company, Clinton Telephone Company, Crutchfield Telephone Company, Fulgham Telephone Company, and Springhill Telephone Company.

(2) To borrow $225,000 from the United States of America and to execute its note and mortgage therefor.

(3) To apply for permits to the State Highway Engineer and fiscal courts of Hickman and Fulton counties for using the highways and roads for telephone lines.

(4) To apply to the city of Clinton to create and sell as telephone franchise in said city.

(5) To construct, maintain, and improve telephone systems in described areas in said counties.

The applicant also seeks to have the Commission determine that the operation of a telephone system in the city of Clinton is necessary in order to serve certain rural areas in Hickman and Fulton counties and that all other telephone companies and co-operatives are unwilling or unable to furnish reasonably adequate telephone service in such area and that no other telephone company is ready, willing, and able to serve said area within a reasonable time.

This case came on for hearing on January 22nd and 23rd, 1952. At that time the Southern Bell Telephone and Telegraph Company (hereinafter referred to as "Southern Bell") filed a motion to intervene in opposition to the application. Said motion was granted by order of the Commission entered January 23, 1952.

The facts of the case as developed by the evidence are these: The Cooperative was incorporated on April 6, 1950, under the provisions of KRS 279.310–279.600 for the purpose of operating a telephone system in Hickman and Fulton counties. The Cooperative proposes to purchase the existing facilities of the Beelerton Telephone Company, Cayce Telephone Company, Clinton Telephone Company, Crutchfield Telephone Company, Fulgham Telephone Company, and Springhill Telephone Company and to consolidate this into a modern dial system adequate to serve the area.

In order to accomplish this, the Cooperative has entered into a telephone loan contract with the United States Government wherein the government will loan the Cooperative $225,000 in order to effectuate the above plans.

The dispute arises out of the fact that Southern Bell, the intervener here, is now rendering service to approximately six hundred subscribers in the territory proposed to be served by the Cooperative.

The foregoing presents two issues for consideration by the Commission:

(1) Whether the Rural Telephone Enabling Act, KRS 279.310–279.600 authorizes the applicant Cooperative to render the desired service. If so, then

(2) Whether public convenience

and necessity require the construction of the proposed facilities.

The pertinent provisions of KRS 279 are KRS 279.360(1) and (2) which read as follows:

"279.360 General powers of rural telephone co-operative corporations. Each corporation organized under the provisions of KRS 279.310 to 279.600 shall have power:

(1) To furnish, improve and expand telephone service in rural areas to its members, to governmental agencies and political subdivisions, and to other persons not in excess of 10 per cent of the number of its members, provided, however, that, without regard to said 10 per cent limitation, telephone service may be made available by a co-operative through interconnection of facilities to any number of subscribers of other telephone systems, and through pay stations to any number of users; and provided, further, that a co-operative which acquires existing telephone facilities in rural areas may continue service to persons, not in excess of 40 per cent of the number of its members, who are already receiving service from such facilities, without requiring such persons to become members upon such terms as may be prescribed in the bylaws; and provided, further, that no co-operative shall (a) construct or operate any line, facility, or system in any rural area being furnished telephone service by any telephone company or other co-operative unless the Public Service Commission shall determine, after hearing on reasonable notice to all interested parties, that any such telephone company or other co-operative is unwilling or unable to furnish reasonably adequate telephone service in such area, or (b) furnish any telephone service in any area proposed to be served by any telephone company, which may be found to be ready, willing, and able to serve, within such period of time as may, after hearing, be determined to be reasonable by the Public Service Commission;

(2) To construct, purchase, lease as lessee, or otherwise acquire, and to improve, expand, install, equip, maintain, and operate, and to sell, assign, convey, lease as lessor, mortgage, pledge, or otherwise dispose of or encumber, telephone lines, facilities or systems, lands, buildings, structures, plants and equipment, exchanges, and any other real or personal property, tangible or intangible, which shall be deemed necessary, convenient or appropriate to accomplish the purpose for which the co-operative is organized; provided, that no co-operative shall construct, purchase, lease as lessee, take, receive, or otherwise acquire, improve, expand, install, equip, maintain, or operate any telephone lines, facilities or system, lands, buildings, structures, plants and equipment, exchanges, or any other real or personal property, tangible or intangible, within the boundaries of any incorporated or unincorporated city, town, village, or borough within this state having a population in excess of one thousand five hundred inhabitants, unless said procedures or any of them are determined by the Administrator of the Rural Electrification Administration to be necessary in order to furnish or improve telephone service in rural areas, and unless said determination by the Administrator of the Rural Electrification Administration, after proper hearing on reasonable notice to all

interested parties, be approved by the Public Service Commission of the commonwealth of Kentucky . . . ."

The prohibitions against service by any co-operative are (a) they shall not furnish telephone service in any rural area now being served and (b) they shall not furnish service in any area proposed to be served by a company which is found to be ready, willing, and able to serve. If either of the two aforementioned situations exist then service by the Cooperative is not within the statute.

An examination of the evidence shows that Southern Bell does propose to serve susbstantially the entire area applied for by the Cooperative.

At the hearing counsel for the intervener made a statement on behalf of Southern Bell whereby they proposed "to provide service in the area which is included in the map which they have filed here, that is, the Cooperative has filed and we will do that under the tariffs, of course, and under the law, and we will also do that within such time as the Commission finds it to be reasonable" (T–12). This proposal was reiterated by Southern Bell's Kentucky manager when he stated in response to a question:

"With the exception of the areas pointed out by Mr. Freeman, namely this small area in which I believe it was testified that there was one Arlington subscriber and in this little area just west of Water Valley over in Graves county, with those two very minor exceptions the Southern Bell Telephone and Telegraph Company is ready, willing, and able to serve each applicant for telephone service within the area, under the laws of the commonwealth of Kentucky and with the tariffs and rates approved by this Commission within such time as this Commission might find it to be reasonable for this installation."

During the course of the hearing Southern Bell presented extensive evidence showing their willingness to serve, the engineering plans and the surveys which they had made preparatory to the actual commencement of construction. There was also evidence introduced as to the ability of Southern Bell to render the desired service. From the foregoing it seems clear that the proposal of Southern Bell to serve was made in good faith and that they stand ready, willing, and able to proceed with their program upon approval of their proposal by the Commission.

The Cooperative seeks to avoid the prohibition of the statute by pointing to the fact that it is acquiring the existing facilities of the Clinton Rural Telephone Company in the city of Clinton and several other existing companies throughout the area. The evidence shows that the Clinton Rural Telephone Company, which operates in the city of Clinton, was serving only 81 subscribers at the time of the hearing and the conclusive evidence pointed to the fact that that service was virtually useless (T–31). This is also true of the other rural companies. (Even so, the prohibition in the statute is absolute. It provides that no co-operative shall serve where another utility proposes to serve and is ready, willing, and able to extend its service to the same area within a reasonable time. It makes no exception in the case where the co-operative acquires existing facilities.)

The rationale of the statute in so far as it precludes service by a co-

operative is clear. The statute was written in this manner in order to avoid the unnecessary and wasteful duplication of facilities and to protect the public from the effects of ruinous competition. The evidence shows that the applicant proposes to spend a substantial portion of its loan allocation of $225,000 to construct facilities that would, in large measure, duplicate the existing dial plant of Southern Bell. If this is done, the inevitable competition that would follow would eventually mean economic waste of valuable telephone property and an increased burden upon the ratepayers involved. Because of this the Commission is of the opinion that it would not be in the public interest to grant the certificate requested by the applicant.

The evidence introduced at the hearing, however, showed an urgent need for telephone service in the area proposed to be served by the Cooperative. As indicated previously Southern Bell also proposes to serve substantially this same area and the Commission is of the opinion that they should proceed with the program as rapidly as possible.

The Commission, therefore, finds:

(1) The Rural Telephone Act, KRS 279.310–279.600 does not contemplate service by a co-operative where an existing company proposes to render the desired service to the same area and stands ready, willing, and able to proceed with this program.

(2) There is a need and demand for telephone service in the areas of Hickman and Fulton counties here sought to be served by the Cooperative and Southern Bell, and that no company, other than Southern Bell, is in a position to extend that service to the residents of this area.

(3) The Southern Bell Company stands ready, willing, and able to proceed with a program to adequately serve the entire area.

It is therefore *ordered:*

(1) That the application of the H-F-C Cooperative be and it hereby is denied.

(2) That Southern Bell Telephone Company proceed with its program, as presented to this Commission, to serve this entire area, and to complete that program as soon as is physically and financially possible.

(3) That Southern Bell report to the Commission every six months from and after the date of this order the progress which it is making toward the completion of this project.

Farmers Electric Co-operative Corporation et al.

v.

Arkansas Power & Light Company

No. 4-9737
— Ark —, 249 SW2d 837
June 2, 1952; rehearing denied July 7, 1952

APPEAL *from lower court judgment reversing Commission determination that electric co-operative had authority to continue to serve territory recently annexed to municipality; affirmed.*

Certificates of convenience and necessity, § 146 — Termination of rights — Co-operative electric company serving territory — Annexation to municipality.

An electric co-operative serving a territory was held not to have authority to serve such territory after annexation to a municipality, where a private company held a certificate to serve the municipality, because the co-operative was certificated to serve a rural territory and when such territory is contiguous to a municipality, the co-operative is put on notice that the municipality will very likely expand.

APPEARANCES: Kaneaster Hodges, Newport, for appellant; Claude M. Erwin, Newport, P. A. Lasley, House, Moses & Holmes, and E. B. Dillon, Jr., all of Little Rock, for appellee; Sherrill, Gentry & Bonner, Fitzhugh & Cockrill, Little Rock, and John D. Eldridge, Jr., Augusta, amici curiae.

GRIFFIN SMITH, CJ.: The point at issue is whether Farmers Electric Co-operative Corporation is entitled to serve patrons now within the city limits of Newport, but who were in a nonurban area when the Public Service Commission, through its certificate of convenience and necessity, authorized Co-operative to occupy the territory. The controversial genesis is 1937 when the Commission allocated certain territories—some to Arkansas Power & Light Company and some to Co-operative.

Newport, pursuant to an election in 1947, undertook to extend its boundaries by incorporating approximately 2,000 acres east and northeast of the city. Because of numerous protests more than half of the territory was omitted, with the result that the area sought to be annexed was reduced to 960 acres. Some property owners were not satisfield with the revision and appealed to circuit court, where the city's annexation petition was de-

nied. An appeal followed. See Newport v. Owens (1948) 213 Ark 513, 516, 517, 211 SW2d 438. In the court's opinion it was said that much of the testimony was directed to territory identified as Lakeview Addition, "and the evidence preponderates in favor of its annexation." An additional statement was: "But a tract of approximately 90 acres lying in the northern part of the territory proposed to be annexed, was shown to be agricultural . . . . It follows, therefore that there is substantial evidence in the record going to show that a material portion of the land sought to be annexed—i.e., the 90 acres—should not be annexed; and because of that evidence and the cases heretofore cited, we must affirm the circuit court judgment."

In consequence of further proceedings in circuit court some of the territory now claimed by Co-operative was annexed. However, prior to such annexation slightly more than $1,300 had been spent by Co-operative for installations necessary to serve the out-of-city territory. The pleadings show that territory was annexed in 1946 and again in 1948. It is therefore probable that on remand of the Owens Case circuit court entered its annexation order after eliminating the land identified in this court's opinion because it was rural acreage not essential to the city's needs. After the 1946 annexation Co-operative spent $12,-808.69 in that separate area, and following the judgment of annexation in 1948 it spent $14,128.80 in the district so joined.

A shoe manufacturing company, "Trimfoot," was located in the territory annexed in 1946. Its operations required a steady use of large quantities of electricity and for a considerable period Co-operative supplied the demand. Trimfoot was not a member of Co-operative and it is insisted it was not eligible to become a member. Attention is called to language used by this court in Arkansas-Louisiana Electric Coöperative v. Public Service Commission (1946) 210 Ark 84, 85, 64 PUR NS 292, 295, 194 SW2d 673, 678, where it was said that, under Act 342 of 1937, "a co-operative . . . may serve members only." Trimfoot has now discontinued operations and the case here does not turn on a membership right.

Trimfoot preferred service by Arkansas Power & Light Company and instituted the proceedings resulting in this appeal by filing its petition with the Public Service Commission. An allegation was that the privately owned power company would not render the service without specific authority, but it stood ready to serve the entire territory if a final order should show that under its indeterminate permit, Act 124 of 1921, the right to do so was exclusive. In other words it is the contention of Arkansas Power & Light that its subsisting permit extends to all parts of Newport; that the city by appropriate procedure enlarged its boundaries; that the municipality as a territorial entity now extends to and includes the annexed area, and that Co-operative's authority under its certificate of convenience and necessity to serve a rural population terminated when the city's necessities resulted in the program of expansion.

On the other hand Co-operative insists that it lawfully entered this particular field at a time when it was ru-

ral, and that irrespective of municipal development or enlargement, the area has been pre-empted. The Commission accepted the result of this view, and circuit court reversed.

The question is one presenting unusual difficulties.

The applicable statute, as heretofore mentioned, is Act 342 of 1937, Ark Stats §§ 77–1101 to 1136. It authorizes co-operatives to organize for the purpose of furnishing electrical energy to persons in rural areas who are not receiving central station service, limited to members of the organization. "Rural area" is defined as any not included within the boundaries of an incorporated or unincorporated city, town, or village *having a population in excess of 2,500 inhabitants,* and including both the farm and nonfarm population. All persons in rural areas proposed to be served by a co-operative who are not receiving central station service shall be eligible to membership in such corporation.

Appellant first argues that circuit court was without jurisdiction because questions exclusively cognizable in a court of law were involved, whereas here the proceedings originated in the Public Service Commission. By § 31 of Act 342 co-operative corporations are exempted from jurisdiction of the Public Service Commission with the exception that before beginning any construction or operation they are required to secure a certificate of convenience and necessity. But in Southwestern Gas & E. Co. v. Hatfield (1951) — Ark —, 243 SW2d 378, 382, The Law Reporter for Nov. 12, 1951, it was said that the nature of the final act of the Commission "was the determination of the question [whether Southwestern Gas & Electric Co. or Rich Mountain Electric Coöperative, Inc.] should in the future own and operate the electric distribution systems in the towns of Hatfield and Cove." It was then said that in making such determination the Commission had power to consider and determine questions of law, or mixed questions of law and fact, "where such questions are germane and incidental to the final legislative act."

In the instant case the legislative act excludes co-operatives from cities and towns where the population is in excess of 2,500. Newport, by reason of population, is admittedly within the proscribed territory unless we can say that the occupancy when the city's boundaries were extended leaves appellant free to continue its operations in spite of the fact that Arkansas Power & Light has a permit to serve the entire city.

A decision dealing with a kindred subject was handled by the Kentucky court of appeals, Truesdale v. Newport (1906) 28 Ky Law Rep 840, 90 SW 589, 590. The city had granted a 20-year franchise to a gas company containing commitments respecting service to extensions. It was argued that the provisions of the franchise covering the collateral obligations rendered the grant void, but the court said:

"If the ordinance had been silent as to the territory [thereafter] taken into the city, the meaning would have been the same. The contract is to supply the city of Newport and its inhabitants with gas. The limits of the city year by year determine the limits of the contract. The city authorities have

no power to contract for anything beyond the limits of the city, and any contract they may make can only bind property within the city, and when property is added to the city it necessarily falls within their jurisdiction."

No doubt the general assembly failed to foresee the conflict here presented when Act 342 was being considered, else some provision would have been made for the awkward situation.

Apprehension is expressed that an affirmance of the circuit court judgment would establish a precedent under which a co-operative, after operating in good faith in an unquestioned rural area where in the beginning the population was such that a major power company would not extend lines to it, might suffer from the mere fact that it aided in developing the community. This, say appellees, might occur if the population passed 2,500. It must be conceded that the law does not provide for an extreme contingency of this kind, and we do not in this opinion, by inference or otherwise, suggest that a co-operative would be automatically ousted with attainment of the maximum population figure.

The circumstances here are quite different. The territory assigned appellant was contiguous to the city. The normal trend of a town or city is to build, hence one claiming rights pertaining only to rural territory enters such an area with notice that the municipal corporation will very likely expand, as Newport did in this case. An anomalous situation would result if it should be judicially determined that rights essentially rural could not be disturbed by city expansion. The serious difficulty arises when compensation is considered. In the case at bar, however, appellee has offered to pay on a fair appraisal basis and it is not suggested that the litigants cannot agree. Their relationships are shown to have continued amicable with frequent acts of reciprocal assistance. Each, within its own field, is serving essential ends and is discharging these duties in a highly satisfactory manner.

We think the trial court correctly construed the law.

Affirmed.

CALIFORNIA DISTRICT COURT OF APPEAL, SECOND DISTRICT, DIVISION 2

James E. Cole, Doing Business As Cole's Detective Investigators

v.

Pacific Telephone & Telegraph Company

Civ. 18933
— Cal App2d —, 246 P2d 686
July 25, 1952

APPEAL *from dismissal of action for damages because of telephone company's omission of listing in classified telephone directory; affirmed.*

Service, § 434 — Telephone — Company liability — Directory error — Service contract.

1. A rule of a telephone company limiting liability for errors and omissions in the listing of subscribers in its classified directory, when filed and in effect pursuant to the requirements of the Public Utilities Act and recited in a subscriber's application for service, becomes a part of the subscriber's contract and, in the absence of any showing that such a rule is unreasonable, is binding upon the subscriber, p. 59.

Service, § 166 — Company liability — Limitations.

2. A telephone company being strictly regulated in all operations, with considerable curtailment of its rights and privileges, should likewise be regulated and limited as to its liabilities, since the reasonableness of the rates of a utility are in part dependent upon the establishment of a rule limiting its liability, p. 61.

Service, § 27 — Court jurisdiction — Rules and regulations.

3. A challenge as to the reasonableness of the rules and regulations of a telephone utility should be directed to the Commission, rather than a court, p. 61.

APPEARANCES: Kenny & Morris and Eleanor V. Jackson, Los Angeles, for appellant; Lawler, Felix & Hall, Leslie C. Tupper, L. B. Conant, Los Angeles, for respondent.

MOORE, PJ.: In January, 1950, appellant contracted with respondent for the latter to insert certain advertising script in its Los Angeles Classified Telephone Directory. The contract contemplated a one-inch advertisement under the title "Detective Agencies" and appellant's name listed in boldface type. The listing and the advertisement were to commence with the

next succeeding issue of respondent's directory scheduled for distribution in September, 1950. After the utility failed to include either appellant's name in the listings or his one-inch advertisement in its directory, he commenced this action for $25,500 as damages allegedly suffered by reason of the breach of contract.

The answer denied any damages resulted from the omission of appellant's material and pleaded affirmatively that, pursuant to its rules and regulations on file with the Public Utilities Commission, liability for omissions from the listings of subscribers in its directories is limited to the amount of the charge therefor, that, by virtue of the fact that appellant had paid nothing on account of the contract, appellant is not entitled to recover any damages for the alleged omission.

When the action was called for trial, respondent, in anticipation of its affirmative defense, objected to any evidence. Such objection having been sustained and judgment of dismissal having been entered, the sole question for decision is whether the facts pleaded by respondent constitute a complete defense to the demands of appellant.

[1] As a public utility corporation, respondent is required under the Public Utilities Act (Deering's Gen Laws, Act 6386, § 14[1]) to file with the Public Utilities Commission a complete schedule of "rates, tolls, rentals, charges . . . to be collected or enforced, together with all rules, regulations, contracts . . . which in any manner affect or relate to rates, tolls . . . or service. . . ." Pursuant to that requirement, respondent had on file the form of contract involved herein and also the rules and regulations relating to its liability for errors in the compilation of its directories. The contract specifically recited, "In case of error or omission of the advertisement by the company, the extent of the company's liability shall be limited to a pro rata abatement of the charge paid to the company as the error or omission may affect the entire advertisement." Such provision is substantially the same as the company regulation duly filed with the Commission.

When such rule is of record with the Public Utilities Commission, its provisions, if reasonable, are binding upon the parties to the contract and will operate to limit the telephone company's liability as therein set forth. Riaboff v. Pacific Teleph. & Teleg. Co. (1940) 39 Cal App2d 775, 778, 3 Cal Supp 194, 34 PUR NS 19, 21, 102 P2d 465, 466. The facts in the Riaboff Case are almost identical with those involved in the case at bar. There the subscriber sought to recover damages for the telephone company's error in misspelling his name with the result that it did not appear in the proper place in the directory. In reversing judgment for the plaintiff the court stated, "The rates charged for such service are governed and fixed by the Public Utilities Act, *supra*. They cannot be varied or departed from and are in part dependent upon appellant's rule of limitation of liability. When such service is contracted for, the rate so fixed by law represents 'the whole duty and the whole liability of (appellant)' (Western U. Teleg. Co. v. Esteve Bros. &

[1] Now Public Utilities Code § 489.

Co. [1921] 256 US 566, 572, 65 L ed 1094, 41 S Ct 584, 586), and 'becomes a part of the contract, and the rights and liabilities under the contract must be determined with reference to the law in effect.'"

In Correll v. Ohio Bell Teleph. Co. (1939) 63 Ohio App 491, 32 PUR NS 82, 84, 27 NE2d 173, 174, cited in the Riaboff decision, the public utility was held to be limited in its liability to a subscriber whose name was omitted from a directory. There a general exchange tariff, a regulation similar to that of respondent's had been duly filed with the Public Utilities Commission. It exempted the telephone company from liability for damage claimed on account of errors in omissions from its directories. The theory upon which the utility's liabilities are regulated and limited by statute is declared to be that "[since it renders] a service affecting the public, the state shall regulate and control it in order to prevent injustice, and, further, in consideration of such regulation and control, its liability is and should be defined and limited. . . . In a sense it is a matter of contract, on the one hand by the utility, and on the other by the state representing all its citizens."

The Western Union Case, *supra*, cited in support of the Riaboff decision, sustained a similar limitation on the liability of the telegraph company for errors in the transmission of a message from Barcelona to New Orleans. The rule providing for such limitation had been filed with the Interstate Commerce Commission. In deriving its conclusion, the Supreme Court in the language of Mr. Justice Brandeis declared: "The limitation of liability was an inherent part of the rate. The company could no more depart from it than it could depart from the amount charged for the service rendered. . . . Uniformity demanded that the rate represent the whole duty and the whole liability of the company. It could not be varied by agreement; . . . 'If the charges filed were unreasonable, the only attack which could be made upon such regulation [limiting liability] would be by proceedings contesting their reasonableness before the Interstate Commerce Commission.'" [256 US at pp. 571, 572, 41 S Ct at p. 586.]

Appellant attempts to distinguish the authorities relied upon by respondent in that they arose out of losses sustained by virtue of errors in the transmission of messages. That was not the basis for the decision of the supreme judicial court of Massachusetts in Wilkinson v. New England Teleph. & Teleg. Co. (1951) 327 Mass 132, 88 PUR NS 156, 97 NE2d 413, 415. That utility had filed with the Department of Public Utilities a rate schedule and regulations. Thereafter, the plaintiff, a hairdresser, caused a telephone to be installed in her shop and paid all bills. Because her telephone gave only desultory service she sued the company for loss of patronage. The court held that (1) the regulation providing for a "'pro rata adjustment of charge'" in the event of complete failure of local exchange service for more than twenty-four hours was an integral part of the relationship which the plaintiff entered into with the defendant and was not unreasonable; (2) the obligations of defendant are limited by that regulation if it is reasonable; (3) there is

nothing to prevent parties from prescribing reasonable rules for the management of the business so long as such rules are made known to their patrons; (4) those rules will operate to abridge the general liability of the public utility at common law.

[2] The theory underlying these decisions is that a public utility, being strictly regulated in all operations with considerable curtailment of its rights and privileges, shall likewise be regulated and limited as to its liabilities. In consideration of its being peculiarly the subject of state control, "its liability is and should be defined and limited." Correll v. Ohio Bell Teleph. Co. *supra*. There is nothing harsh or inequitable in upholding such a limitation of liability when it is thus considered that the rates as fixed by the Commission are established with the rule of limitation in mind. Reasonable rates are in part dependent upon such a rule.

Although appellant zealously urges that such provision seeking to limit the company's liability for its own negligence is void because, contrary to public policy, he cites no authority where consideration is given the problem with regard to tariff regulations on file with the Public Utilities Commission. Cases such as Union Construction Co. v. Western U. Teleg. Co. (1912) 163 Cal 298, 125 Pac 242, and Hiroshima v. Bank of Italy (1926) 78 Cal App 362, 248 Pac 947, are therefore not pertinent.

[3] Appellant contends that he has been forestalled of an opportunity to question the reasonableness of respondent's rule limiting liability. Such questions of reasonableness should first be directed to the Public Utilities Commission which by § 35 of the Public Utilities Act is vested with jurisdiction to make such determination. See Carpenter v. Los Angeles Gas & E. Corp. (1940) 41 Cal App2d 369, 373, 374, 37 PUR NS 115, 106 P2d 916. If, after complaint to the Commission, a party is still dissatisfied, he is free to invoke the appropriate extraordinary remedy.

Judgment affirmed.

McComb and Fox, JJ., concur.

Cincinnati Gas & Electric Company et al.

v.

Public Utilities Commission

Nos. 32958, 32959
— Ohio St —, 106 NE2d 642
May 28, 1952

APPEAL *from Commission order denying a natural gas company authority to increase the number of space-heating customers but granting such authority to other companies, and from Commission order prescribing certain emergency rules and regulations and exacting a penalty for failure to abide therewith; affirmed.*

Discrimination, § 205 — Right to supply natural gas for space heating — Preference during shortage of supply.

1. A Commission order denying a natural gas company authority to increase the number of space-heating customers, but granting such authority to other companies, was not unlawfully discriminatory where there was a natural gas shortage in the state and where the number of additional consumers which the companies could, within the limits of their respective and presently available supplies, add to their lines varied as between the companies, p. 64.

Service, § 161 — Commission rule — Gas company supervision of ineligible service — Ministerial duty.

2. A Commission rule requiring natural gas companies to determine whether a customer has connected space-heating equipment which is not eligible for service, to direct the consumer to disconnect such equipment if ineligible, and to discontinue the gas supply if the consumer fails to comply with such direction, does not require the exercise of a judicial or quasi judicial function, or delegate legislative power to the companies but imposes only an affirmative ministerial duty on such companies, p. 64.

These two cases are in this court on appeal from an order of the Public Utilities Commission, denominated "Ninth Supplemental Emergency Order" and dated December 13, 1951, regulating and restricting the supply of natural gas the gas utilities may serve for gas-fired space-heating equipment. The first of this series of emergency orders, dated October 3, 1947, was appealed from to this court in the case of Akron v. Public Utilities Commission (1948) 149 Ohio St 347, 74 PUR NS 81, 78 NE2d 890.

By its Ninth Supplemental Emergency Order, the Commission found that there was a continuing emergency affecting the health, safety, and welfare

of the people of the state, due to the continuing unprecedented demand for gas and to the inability of the gas utilities to make available sufficient additional gas to consumers; that such condition necessitated curtailments of gas service; and that the number of consumers which the natural gas companies of Ohio can, within the limits of their respective and presently available gas supplies, add to their lines varies as between the companies.

Based upon its finding of facts, the Commission, by its order, denied to The Cincinnati Gas & Electric Company authority to increase the number of its space-heating customers, but granted to other gas companies authority to approve applications for additional space-heating service.

In the same order the Commission prescribed certain emergency rules and regulations to be followed by the gas companies in carrying out the terms of the order and exacted a penalty on any gas utility and its responsible officers for failure to abide by the provisions of the order.

Rule 4 prescribes that, when the evidence reasonably indicates that any consumer has connected gas-fired space-heating equipment which under the rules is not eligible for service from the utility's lines, the utility shall forthwith in writing direct such consumer to disconnect such equipment and discontinue the use of such service, and, if the consumer fails to do so within ten days, the utility shall discontinue the entire supply of gas to such consumer, and that before reestablishing service the utility "shall take such measures as may be deemed practicable and necessary to restrict the flow of gas to quantities required for other than space-heating purposes."

Rule 5 requires distributing utilities to curtail natural gas service to industrial consumers when and to the extent necessary to supply demands during peak periods to domestic consumers, in accordance with the Commission's order, and to restore such curtailed service when the emergency is past.

Rule 6 prescribes that "no action taken by any such distributing utility in compliance with these rules shall be deemed to constitute unjust discrimination or a violation of any of the provisions of the Public Utilities Commission Act, the general orders of this Commission, or the schedules, rules and regulations of such utility."

It is contended by the appellant utility that the Commission erred (1) in imposing a "complete freeze" on appellant by denying its request to be permitted to approve applications for space-heating service and thus discriminating against appellant in favor of other gas companies, and (2) in unlawfully subdelegating to the gas utilities the responsibility of enforcing the Commission's emergency restriction order regulating the amount of gas the utilities may serve for space heating, of determining whether the order has been violated, and of punishing any violators without prescribing a formula for determining violations or providing the suspected violator a hearing or the violator a review.

APPEARANCES: Peck, Shaffer & Williams and Walter E. Beckjord, Cincinnati, for appellant Cincinnati Gas & Electric Co.; Henry M. Bruestle, City Solicitor, and Robert J. White, Cincinnati, for appellant city

of Cincinnati; C. William O'Neill, Attorney General, and John P. Case, Columbus, for appellee.

PER CURIAM:

[1] The validity of a statewide temporary "freeze" order of the Commission prohibiting any distributing utility from furnishing additional service for space heating has been upheld by this court in the case of Akron v. Public Utilities Commission (1948) 149 Ohio St 347, 74 PUR NS 81, 78 NE2d 890. The record before the court in the instant cases clearly justifies the finding of the Commission "that the number of additional consumers which the natural gas companies of Ohio can, within the limits of their respective and presently available gas supplies, add to their lines varies as between companies," and supports its order denying to the appellant company authority to increase the number of its space-heating consumers and granting to other distributing utilities authority to approve applications for additional space-heating service. The order is not unlawfully discriminatory.

[2] The enforcement provisions of the order in question are not a delegation of legislative power to the distributing utilities, and the rules above referred to are within the rule-making power of the Commission. The distributing utilities are not authorized to make any rules or regulations concerning the addition of space-heating customers to their gas lines but are required to perform purely ministerial duties. The rule of the Commission requiring the distributing utility to determine whether a customer has connected gas-fired space-heating equipment which is not eligible for service, to direct the consumer to disconnect such equipment if he has made such a connection, and to discontinue the supply of gas to the consumer if he fails to comply with such direction does not require the exercise of a judicial or quasi judicial function. The answer to the question is peculiarly within the knowledge of the utility, and if it is in the affirmative a ministerial duty is imposed on the utility to discontinue the supply of gas to such customer.

The order of the Commission is affirmed.

Order affirmed.

Weygandt, CJ., and Zimmerman, Middleton, Matthias, and Hart, JJ., concur.

Stewart, J., not participating.

Industrial Progress

A digest of information on new construction by privately managed utilities; similar information relating to government owned utilities; news concerning products, supplies and services offered by manufacturers; also notices of changes in personnel.

Arizona Public Service Plans $125,000,000 Program

ARIZONA PUBLIC SERVICE CO. plans to spend $125,000,000 in the next 10 years to expand electric, gas and water service, according to an announcement by Henry B. Sargent, president. Ground-breaking ceremonies were held recently for the company's 200,000 kilowatt Saguaro power plant in southern Arizona.

Located 30 miles north of Tucson, the plant will be the state's largest outdoor type generating installation. The plant will be capable of producing nearly 25 per cent more power than Arizona's entire share of Hoover Dam power.

The cost of the initial unit will be about $14,000,000, Mr. Sargent said.

New York State Elec. & Gas To Observe Centennial

THE NEW YORK STATE ELECTRIC & GAS CORP. will celebrate 100 years of public service with a series of centennial observances at various points in the state on October 28, 1952.

The general observance will be highlighted by employees' centennial birthday dinner parties in numerous communities throughout the company's service area.

The company was incorporated on October 28, 1852, as the Ithaca Gas Light Company. It began business with a capital stock of $75,000 as one of the leading concerns in the then small city of 7,000 population.

In a century, the capital investment has increased to more than $183,000,000 and the area served has been extended to 35 per cent of that of the state. Meanwhile, Ithaca alone has grown to become a city of 30,000.

Other cities in the company's present area with gas service dating back 100 years are: Auburn, Elmira and Lockport.

One of the principal events of the day will be groundbreaking ceremonies at Heddens, 15 miles north of Ithaca on the east shore of Cayuga Lake, where the company will construct a 500,000-kilowatt steam electric generating station on a tract of 100 acres. The projected plant was recently named Milliken Station as a tribute to Arnold W. Milliken, vice president and general manager.

Business Telephone System

How the Union Oil Company, California, uses its own private, "inside" P-A-X business telephone network to bring increased efficiency and close control to its operations is described in a new, color-illustrated brochure released by Automatic Electric Company, 1033 W. Van Buren street, Chicago 7, Illinois.

M-H Introduces New Gas Valve

A NEW diaphragm gas valve that is interchangeable with standard solenoids and operates on all gases is announced by Minneapolis-Honeywell Regulator Company.

As a result of two years of field testing before its introduction, company engineers claim that the new valve is the most trouble-free diaphragm gas valve in their experience. Cast aluminum body and housing, larger pilot passageways and a three-ply diaphragm using a nylon interior sandwiched between the same Buna-N rubber that goes into the firm's well known aircraft fuel gauge are features that were built into the new valve to minimize servicing. The control is available in a variety of models, sizes and voltages.

The compactness of the control allows it to fit into smaller spaces than regular size valves, yet it equals them in capacity and performance, according to the company. It meets all local codes and gas utility requirements for all gases.

Industrial Electrification Award Offered Through EEI

ROUNDING out the already numerous and diversified Prize Awards administered through the Edison Electric Institute, the new More Power to America Awards by General Electric Company offer the many utilities who have accomplished outstanding results in the industrial electrification field a brand-new opportunity not only to obtain well earned recognition, but also to publicize their achievements. In line with the policy of encouraging small and medium-size companies to enter the EEI Prize Award Contests, General Electric is offering two awards in the More Power to America contest: one for companies with less than 250,000 total meters, and one for companies with 250,000 total meters or more.

Each company entering any of the EEI Prize Award Contests must also bear in mind that no

(*Continued on Page 34*)

entry can exceed 15 in. x 18 in. in size. This is a mandatory restriction and entries not conforming will be disqualified. A plea is also being made that all entries be simple in form and factual in content.

A number of the Prize Award Contests provide various awards for different size companies. There are also some other minor changes in terms and conditions which are clearly set forth in the brochures describing the various contests. Write to the Edison Electric Institute, 420 Lexington avenue, New York 17, New York, for brochures descriptive of the terms and conditions of any or all of the awards.

Pacific Pwr. & Lt. Conducts Appliance Survey

MORE than two-thirds of all homes served by Pacific Power & Light Company are now cooking and heating water electrically, according to findings of an appliance survey being conducted by the utility. The company serves the states of Oregon and Washington.

Electric ranges are in use in 71 per cent of the urban and rural homes surveyed and 69 per cent have electric water heaters, the study disclosed. Corresponding national average figures are 23 per cent and 13 per cent.

The survey also showed electric refrigerators to be almost as popular as radios, with 92 per cent of the homes having this type of refrigeration and 97 per cent reporting radios.

Analysis of appliance buying intentions disclosed that ranges, water heaters and home freezers top the housewife's shopping list, with about one home in every six being a prospect for the purchase of one or another of these pieces of equipment. Automatic washers came close behind in purchase popularity.

Toledo Edison Plans $25,000,000 Station

A BAY shore plant site of approximately 400 acres is being acquired by the Toledo Edison Company to accommodate a new $25,000,000 generating station, Charles E. Ide, president, reported recently.

Plans call for construction of a steam generating station near the bay shore east of Harbor View and installation of equipment capable of producing 125,000 kilowatts of power, Mr. Ide reported. Included will be a high-pressure boiler, a turbogenerator, a condenser and the needed switching and sub-station equipment. Provisions will be made in construction so that four to six more units can be added as the Northwestern Ohio power demand grows.

Other sections of the area will be used for such yard facilities as coal-handling equipment, railroad tracks and ash-disposal areas.

Construction probably will begin by the end of this year and the plant is expected to be in operation by mid-1955, Mr. Ide said. The new unit, which will be the largest on the Edison system, will be the third to be added since the end of World War II. The company has spent more than $53,000,000 for expansion in the last ten years.

Paulsen-Webber Opens New Branch in Houston

ESTABLISHMENT of a ninth branch office and a warehouse with shop facilities in Houston, Texas, by the Paulsen-Webber Cordage Corporation of New York, N. Y., was announced recently by Fredrik B. Paulsen, president of the corporation. The new premises will be used for fabrication and to stock the various materials of the Paulsen-Webber line.

The Texas establishment is part, Mr. Paulsen said, of an expansion program started early in 1951 which has tripled the company's wire rope production and boosted current sales to an all-time peak.

Westinghouse Offers Electric Power Teaching Aids Kit

A KIT of related teaching aids designed to help young students—grades 7 through 9—get a better understanding of the importance of electric power to the growth of America has been developed by the School Service Department of Westinghouse Electric Corporation. The kit—which will be distributed to schools through electric power companies—includes: three wall charts, a cartoon-type booklet on electric power, a steam-turbine generating station model, and a teacher's guide.

According to L. M. Stark, manager of the School Service Department, the "Electric Power Kit" was developed with the advice and guidance of a Consulting Committee composed of four nationally prominent educators of the National Education Association. In addition to the Consulting Committee, other educators, as well as electric utility people, assisted in the development of the kit.

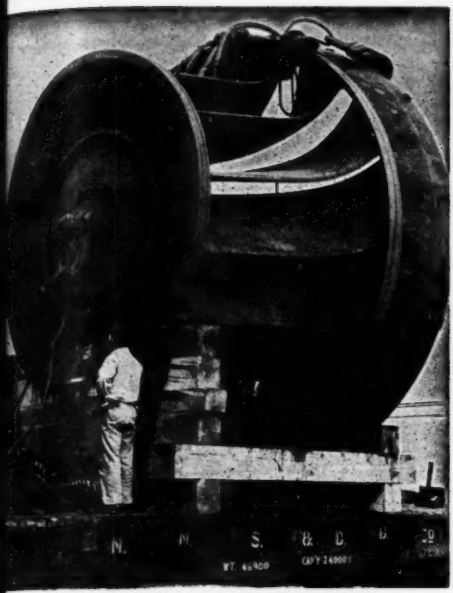
The kit which is packaged as a unit, sells for $5.00 and is available from any Westinghouse office. Each unit includes: 1 set of charts, 40 booklets, 1 model and 1 Teacher's Guide.

"By distributing the kit through electric power companies," Mr. Stark stated, "it is hoped that the resources of the school and the electric power company can be combined to help young people gain a general understanding of the electric industry and a realistic appreciation of its operation in their own community."

New P&H Catalog

A LARGE "Picture Book" of its Model 255-A power shovel has been published by Harnischfeger Corporation. This 24-page bulletin makes liberal use of detailed photos to show design features and the various components of this ¾ cubic yard machine which easily converts for seven different services: shovel, dragline, crane, clamshell, trench hoe, pile driver, and magnet crane. Many action shots of these machines at work, plus two pages of plant scenes showing actual manufacturing operations, round out the pictorial content of the book.

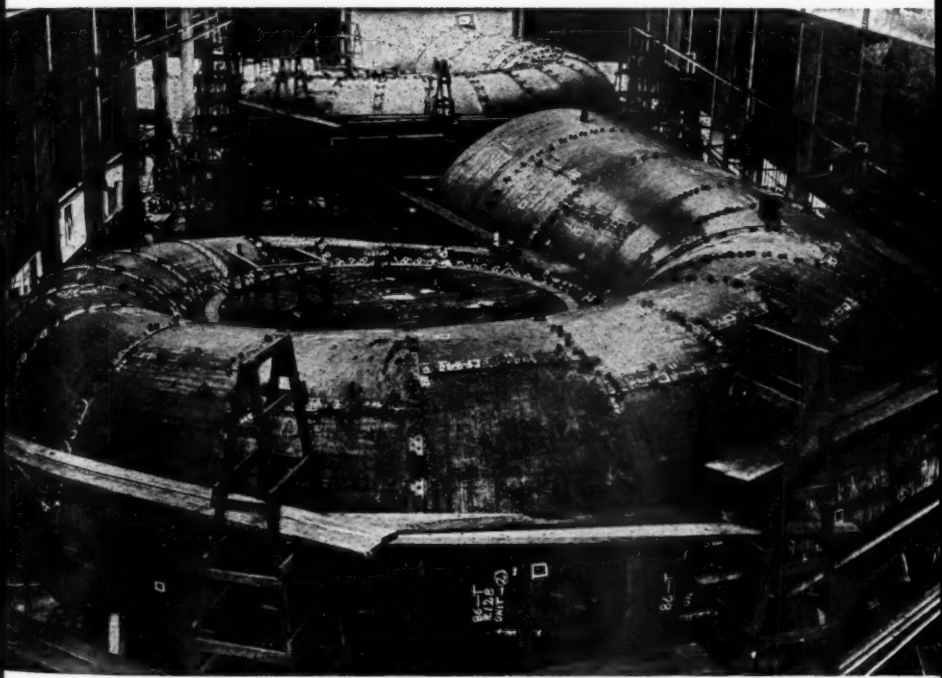
For copies of bulletin X71-4 write Harnischfeger Corporation, 4400 W. National avenue, Milwaukee 46, Wisconsin.



RUNNER FOR BUGGS ISLAND DEVELOPMENT

OVER EIGHT MILLION HORSEPOWER

The Newport News Shipbuilding and Dry Dock Company has received orders for the building of hydraulic turbines aggregating output of 8,150,000 horsepower.



ASSEMBLY OF SPIRAL CASINGS FOR C. J. STRIKE DEVELOPMENT

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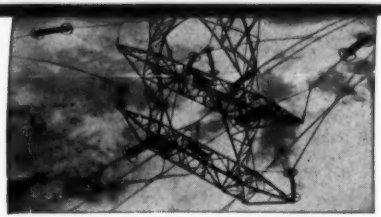

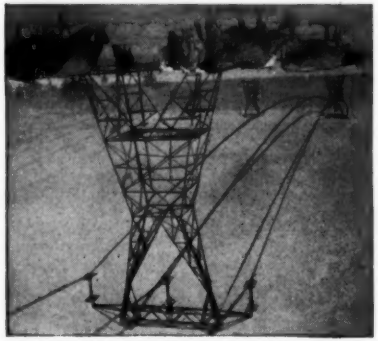

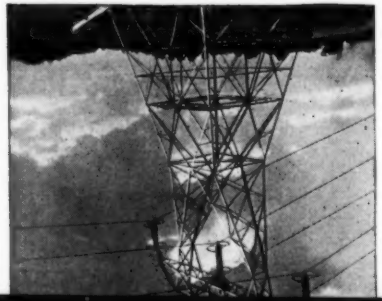

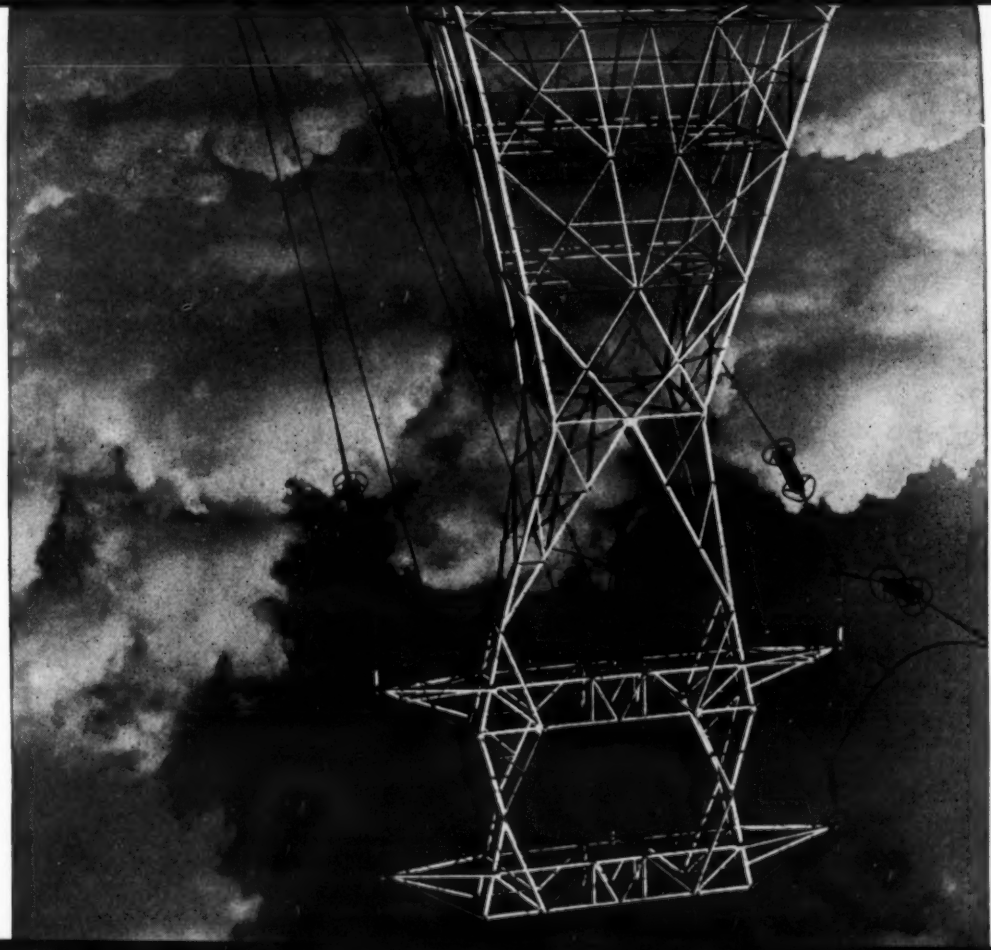

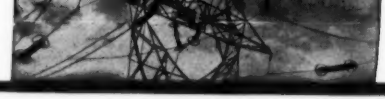

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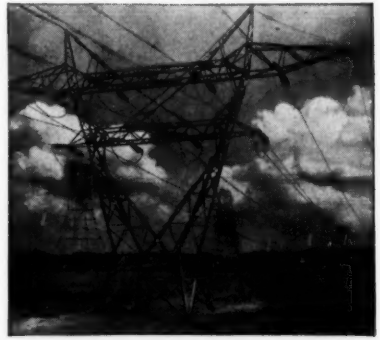

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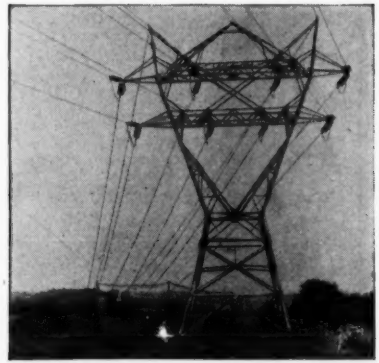

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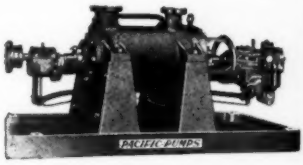

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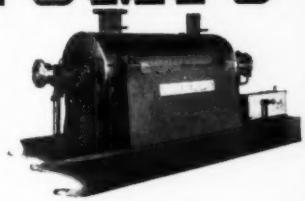

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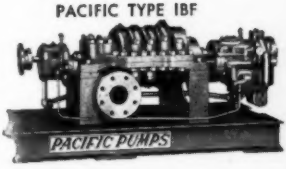

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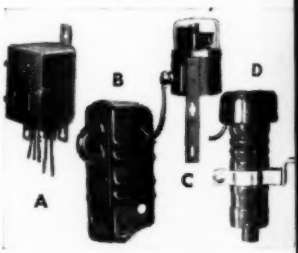

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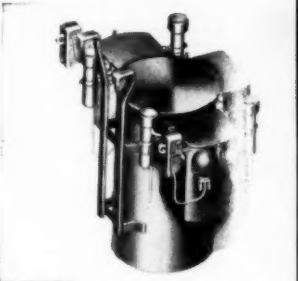

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